

Electricity is hope

A case study of FDI in Georgia's hydropower sector

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Master Thesis
European and American Studies
Faculty of Humanities

UNIVERSITY OF OSLO

Spring 2013

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2013

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Trykk: Reprosentralen, Universitetet i Oslo

Abstract

Georgia has since independence struggled with the issue of stable energy supply. After the Rose Revolution in 2003, the Georgian society went through significant changes where many challenges were successfully dealt with, including an evident reduction in corruption. Nevertheless, the issue of energy supply continued to be troublesome. An important part of the new energy policy introduced in 2006 was the utilising of domestic hydropower resources. Having one of Europe's largest untapped hydropower potential the Georgian politicians wanted to maximise this opportunity, however, the country did not have the human resources and finances to do so. Following a neoliberal approach where FDI is considered unquestionably beneficial, it was decided to attract FDI so that greenfield hydropower plants would be constructed.

This thesis analyses the impacts of FDI in the hydropower sector after 2006, and the main question is in what ways the Georgian government's search for FDI in the hydropower sector have had an impact on social and environmental aspects of the society. This thesis is a case study of two foreign companies that will construct greenfield hydropower plants in the Autonomous Republic of Ajara. The analysis is mainly based on 18 interviews with different stakeholders in the Georgian hydropower sector in November 2012, but also utilises secondary literature. By looking beyond the quantitative numbers of FDI, this thesis aims at shedding light on how the different stakeholders evaluate the greenfield hydropower development and its challenges. If properly managed, FDI may contribute to development both for the country and the affected population. The purpose is to find out how the two cases fit in to the development after 2006, and how they affect in terms of the environmental, economic and social aspects.

Acknowledgements

First of all, I would like to thank my supervisor Pål Skedsmo for his guidance and valuable feedback throughout the process of writing this thesis.

A “didi madloba” to my friends and former colleagues at Clean Energy Invest/ Adjaristsqali LLC. Thanks for the hospitality and for letting me be part of the team! I would also express gratitude to all my interviewees who shared their information and points of view with me.

I am grateful for all the support from my parents. A special thanks to my mother for the assistance throughout this process.

I would also like to thank Siri and Richard for proofreading of reading my thesis.

Last but not least, thanks to Andreas for all the help and support whenever needed.

I am responsible for any inaccuracies or mistakes in this thesis.

Line Kristin Haug

Oslo, 12.05.2013

Abbreviations

AGL: Adjaristsqali LLC

BTC: Baku-Tbilisi-Ceyhan

CEG: Clean Energy Group

EDBI: Ease of Doing Business Index

ENP: European Neighbourhood Policy

ESIA: Environmental and Social Impact Assessment

EU: European Union

FDI: Foreign Direct Investment

GDP: Gross domestic product

GEL: Georgian Lari

GNERC: Georgian National Energy and Water Supply Regulatory Commission

IFC: International Finance Corporation

IMF: International Monetary Fund

MW: mega watt

NGO: non-governmental organization

OLI: Ownership-Location-Internalization

SFSR: Soviet Federative Socialist Republic

SSR: Soviet Socialist Republic

USAID: United States Agency for International Development

USD: United States Dollar

Map of Georgia



Available at <http://www.un.org/Depts/Cartographic/map/profile/georgia.pdf>, accessed 05.05.2013

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“We must make every family feel the achievements in the field of energy.”

Prime Minister Vano Merabishvili.

<http://en.trend.az/capital/energy/2056405.html>, accessed 01.11.2012

1 Introduction

Since the fall of the Soviet Union, Georgia has been struggling to become a democracy with a well-functioning market economy. After the Rose Revolution in 2003 the Saakashvili government introduced comprehensive reforms, which have resulted in many accomplishments, including a clear reduction in corruption and the peaceful reintegration of the Autonomous Republic of Ajara¹. Another important achievement has been an improvement in energy supplies, including a commitment to utilise Georgia's own hydropower potential.

Having struggled with unreliable energy supplies since independence, Georgia wanted to develop its domestic hydropower potential, but lacked the financial strength and human know-how to do so. Accordingly, the country therefore introduced several measures to attract foreign direct investment (FDI) in the hydropower sector. There are several advantages associated with FDI and hydropower projects, with potential economic benefits that include taxes from investments, foreign cooperation, job creation, the introduction of new technology and know-how, and a more stable energy supply. It is interesting to look at how and to what extent the government has achieved its initial plan to get as much as possible in return for FDI in large hydropower. It appears there is a consensus among the Georgian political elite that FDI is advantageous for the country, and it raises the question whether politicians have placed higher value on FDI than on other important aspects of development, such as potential environmental and social consequences.

Through a case study of two foreign hydropower investors in Ajara, this thesis seeks to examine the impact of FDI in the Georgian hydropower sector since 2006. With Georgia being labelled as “the number one reformer in the world” in 2007 by the World Bank's Ease of Doing Business Index, Georgian politicians are eager to implement reforms (worldbank.org). However, the index tells one story, while the lives of ordinary citizens tell a rather different story. Living in Batumi in the spring of 2012, I could see the significant contrast between the constructions of ultramodern buildings in the city while the citizens

¹ Different spellings the autonomous republic include Adjara, Adzhara, Ajaria, Adjaria, Adzharia, Achara, Acharia, Ajaristan and Ajara. Even the government is inconsistent in its spelling, but since it is officially **named** the Government of Autonomous Republic of Ajara, Ajara will be used in this thesis.

experienced power cuts almost every week. Working as an intern at a hydropower company, I asked myself in what way the ongoing development would be beneficial to Georgia.

1.1 Previous research

Most of the existing literature on FDI in the energy sector in the South Caucasus is related to the oil and gas sectors in neighbouring Azerbaijan (see e.g. Oksan 2010, Mehdiyeva 2011). There is only a small amount of literature related to FDI in the hydroelectric sector in the South Caucasus or other similar post-soviet countries (e.g. Løchen 2011). Apart from some reports by local non-governmental organisations (NGOs), few if any studies have thoroughly addressed the environmental and social impact of hydropower development. The few relevant studies tend to be investor oriented (e.g. USAID 2010, Econ 2010). Despite its importance, the long-term impact of energy reform on the national economy has barely been studied (Lampietti 2004, 25).

1.2 Research question

In the context of Georgia's quest to become a net exporter of hydropower electricity, I hope that the thesis will make a contribution to understanding hydropower development in Georgia. Therefore, this thesis will look at whether and to what degree the construction of new hydropower facilitates the social and economic situation in the country. The main research question of this thesis is as follows: *In what ways does the quest for FDI in Georgia's hydropower sector have an impact on social and environmental aspects?*

Furthermore, the following sub-questions will be addressed in order to clarify important aspects of this development;

- *What has been Georgia's strategy for attracting FDI in the greenfield hydropower sector?*
- *What is the status of property rights in Georgia, and how does it affect the land acquisition process during the two projects?*
- *To what degree does FDI in the energy sector affect the environmental standards?*

- *To what extent will the two cases examined in this thesis contribute to improvement in the affected areas, for instance, in terms of tax revenues, employment possibilities and communication flow between the companies and the affected population?*

The following section gives more information about the two cases that will be examined in greater detail in subsequent chapters.

1.3 Presentation of the two cases

In this section I will introduce the two case studies to be examined in this thesis, namely Ajar Energy 2007 and Adjaristsqali LLC. The two cases have similarities, including that the companies are both subsidiaries developing their first hydropower project. The location for both projects is the Autonomous Republic of Ajara, near the Turkish border. Both companies come from countries with a long tradition of hydropower. The projects are the results of the Georgian government's commitment to attracting FDI and the development of greenfield hydropower since 2006. In addition, both projects will export most of the electricity produced to Turkey and will provide electricity to the domestic market only during the high-demand winter months, a service they are legally obliged to provide during the first ten years of their operation (menr.gov.ge 2011b). Both projects have been delayed because the projected production start-up dates have been pushed back, but nevertheless they have developed far enough that it is expected that both projects will be completed.

1.3.1 Ajar Energy 2007

Ajar Energy 2007 Ltd, referred to hereinafter as the Ajar project, is a subsidiary of the well-established Turkish company Eksim Investment Holding. Eksim Investment Holding is a large investment group in Turkey with assets both at home and abroad. The group's investment portfolio includes businesses in many sectors such as energy, mining, real estate and construction. In the hydropower sector, the company has long experience and holds project portfolios with a capacity over 350 MW (Eksim.com 2011).

As the name indicates, the company was established in 2007, and the case to be studied is the subsidiary's first hydropower project. The Ajar project reached a preliminary agreement with the Georgian government in February 2008 and a full agreement in June 2009. With this agreement, the company received a concession to utilise the potential of the lower part of the

Chorokhi River in Ajara. Chorokhi is a trans-boundary river with the main part located in Turkey. The company has an office in Batumi, where it currently employs both Turks and Georgians. Preliminary studies for the project started in 2011. In 2012 the company obtained a construction license, and construction work started in the same year. The hydropower project is expected to be completed by 2016 (investinbatumi.ge 2011).

The Ajar project plans to construct two plants, the Kirnati and the Kelvachauri hydropower plants. The projected installed capacity is 74 MW and the estimated cost is more than 125 million USD. If the project should be completed within the projected time, it will become the first-large scale greenfield hydropower project in Georgia as a result of the energy policy that was been in place since 2006 (UNFCCC 2006, 15). The development process started somewhat earlier for the Ajar project, and therefore it has progressed further in comparison with the Adjaristsqali LLC.

1.3.2 Adjaristsqali Georgia LLC

Adjaristsqali Georgia LLC, referred to hereinafter as the AGL project, is a subsidiary of the Norwegian-based company Clean Energy Group (CEG). The ownership of the company is divided between CEG's management team and Norsk Mineral AS, a Norwegian industrial company with interests in energy, as well as other sectors. In addition, CEG has signed a joint development agreement with IFC, a member of the World Bank Group, making the international financial institution a co-developer of the project (cleanenergygroup.no 2011a).

According to the company's website, CEG was set up to "develop greenfield hydro projects in countries with sustainable energy framework and untapped hydro potential" (cleanenergygroup.no 2012b). The project in Ajara is its very first project. However, the company's founders have considerable experience in the Norwegian hydropower sector with companies such as Statkraft. The project is located in the mountainous areas of Ajara, not far from the Turkish border. More precisely, it is located by the Adjaristsqali River and its tributaries. The river is 90km long and has an average height of 1,400m above sea level. The river gets its inflows from rainfall (44%), groundwater (30%) and snowmelt (26%) (UNFCCC 2012, 4). The Adjaristsqali River joins the Chorokhi River from the east at a point approximately 17km from the Black Sea (UNFCCC 2012, 4).

AGL took part in a tender process in March 2010 and was awarded the development rights about a month later. It took a year to negotiate the agreement, which was finally signed in June 2011 (UNFCCC 2012, 27). The estimated cost of the project is between 300 and 700 million USD, which may make this hydropower project one of the largest FDI investments in the country (cleanenergygroup.no 2011a). At the time of writing, the company has not yet received a construction licence, but it is expected that this will be granted in May 2013. From 2012, AGL had both Georgians and international staff working in the company offices in Batumi and on location (cleanenergygroup.no 2012).

The plan is to construct two hydropower plants. The Shuakhevi hydropower plant will have an installed capacity of 185 MW (cleanenergygroup.no 2011a). The second hydropower plant is called Koromkheti, and it is projected to have an installed capacity of 150 MW (MacDonald 2012, 14). Providing all goes according to plan, the start of the operational phase for the two plants will be in 2016 and 2018, respectively (cleanenergygroup.no 2012).

1.4 Concepts

Here I will explain some of the concepts that are vital for understanding the discussion in this thesis. First is the term foreign direct investment (FDI), defined as a financial investment in an enterprise that operates in a different country of origin than the investor. International organisations such as the OECD often define FDI as a situation where the proportion of foreign ownership is equal to or greater than 10% of the shares in a corporation (Zarsky 2005, 15). The IMF defines it as “a category of cross-border investment associated with a resident in one economy having control or a significant degree of influence on the management of an enterprise that is resident in another economy” (IMF 2009, 100). The IMF also uses the 10% rule noted above (IMF 2009, 101). This thesis examines two cases, both of which are hydropower companies fully under foreign ownership with the entirety of the financing coming from outside Georgia. The companies are in the form of subsidiaries, often known as daughter companies. The IMF defines a subsidiary as “a direct investment enterprise over which the direct investor is able to exercise control” (IMF 2009, 101). The cases have a normal multinational structure with national mother companies in Turkey and Norway, respectively, which have both established a Georgian subsidiary.

FDI is a part of the global financial economy, and it is associated with theories on economic growth (Zarsky 2005, 99). However, the notion that FDI promotes growth has been much debated, and the outcome can depend on several factors (Moran, Graham *et al.* 2005, 197). Therefore, it is vital to recognise that FDI is not a homogeneous phenomenon. In terms of this thesis, the investments are both in the energy sector, more precisely in hydropower. FDI might contribute to national development if the country's export competitiveness is increased, and if human skills and technology are upgraded. These and other positive side effects of FDI are called spillover. On the other hand, FDI might result in negative impacts, such as outcrowding the national companies, unsustainable environmental consequences and social unrest (Zarsky 2005, 98).

Furthermore, the thesis deals with a specific type of FDI, namely investment in a greenfield project, which occurs when a new unit of production is built. The cases in this thesis are hydropower plants built from scratch. Mergers and acquisitions constitute the other form of FDI, which is when foreign companies buy existing assets (Lee and Vivarelli 2004, 158). The greenfield hydropower plants are part of Georgia's energy development strategy. Development is a term with multiple connotations, but in this thesis it will be broadly defined as a country's change in terms of economic growth. It can also be simply defined as improvement in the lives of citizens (Inadomi 2010, 17). For instance, the availability and affordability of energy has the potential to contribute to economic growth and improve the standard of living in Georgia.

The hydropower sector is divided into three segments along the value chain. The first is generation where the actual production of energy happens in hydropower plants. This segment is the focus of the thesis, as the two companies are the owners and builders of the plants. The second segment is transmission, whereby electricity is transferred from the plant and distributed. Finally, there is the retailing of the electricity (investinbatumi.ge 2011). In terms of hydropower plants, an output of less than 10 MW is considered to be a small plant (Demirbaş 2002s, 35). In Georgia, plants with less than 13 MW capacity do not need a generation license and are exempt from comprehensive social and environmental assessments (investinbatumi.ge 2011). The cases in this thesis are larger than 13 MW and thereby subject to the studies.

It is also worth defining some terminology linked to Georgian society. First, there is the issue on whether the Soviet Union should be called a communist, soviet or socialist society. Some argue that in reality the USSR never fully achieved its communist ideals and the term socialism has taken different forms all over the world and thus, I prefer to use the term soviet as I find it more relevant to describe the Georgian past reality (Papava 2005, 17). This leads to another question regarding whether one should label Georgia as a post-soviet country; for how long should the country be labelled as such? Some have argued that the successor states of the Soviet Union are more shaped by the soviet past than the Eastern European countries (e.g. Stiglitz 1999). Although Georgia has changed substantially since the fall of the Soviet Union, some of the features still remain such as a large bureaucracy.

Transition is yet another tricky term used by a number of academics (e.g. Pelkmans 2006; Neuhaus 2006; Jones 2013). The term is somewhat problematic since every society is in transition in the sense that no society stands completely still, and therefore some scholars have referred to the process that took place across Eastern Europe and the Caucasus in the 1990s as transformation (e.g. Rose 2009; Åslund 2006). Transformation is swift and pervasive, but as Rose notes, perhaps Eastern European politicians and Western economists may have preferred to refer to the process in the early 1990s as transition, since this implies predictability and knowledge of where one is headed, instead of the more uncertain connotations of transformation (2009, 1). This thesis will refer to a Georgian transformation period in terms of moving from one economic and political system to another during the early 1990s. The period after transformation will be referred to as an ongoing transition (Papava 2005, 16–17).

1.5 Outline of thesis

This thesis has six chapters, organised into two main parts. The first part consists of chapter one through three. In chapter two, I will present a historical narrative on Georgia. Being a student of area studies, I believe that understanding the general situation is vital to assess the context of which the two cases operate. Chapter Three will present the theoretical and methodological framework of the thesis.

The second part of the thesis will be devoted to presenting and analysing the data found. Chapter Four will look at the energy policy and land acquisition. Chapter Five will examine at the environmental and social issues related to the question of this thesis. Summing up in Chapter Six, the theoretical framework will be re-applied to shed light on the findings.

2 Chapter 2: Background

This chapter will give a brief outline of the history of Georgia. Located between the east and the west, Georgia has always shared borders with larger and more powerful states, dating from the Persians and the Ottoman Empire to the Russian Empire, the Soviet Union and today's Russian Federation. This has affected the country's history as well as its present situation. The present thesis will focus on the period between 2006 and 2013, with emphasis on the political and economic situation in the post-Rose Revolution period. However, before discussing the main features of present-day Georgia I will give a brief historical overview, as some elements from the past still affect the country today.

2.1 The Soviet period in Georgia

Georgia had a short-lived period of independence between 1918 and 1921 before it was occupied and became a part of the Soviet Union. Within the union, modern-day Georgia was first incorporated into the Transcaucasia SFSR along with Armenia and Azerbaijan. This republic was broken up in 1936, and the Georgian SSR was created and lasted until the fall of the Soviet Union (Kappeler 2001, 372).

As Yuri Slezkine (1994, 415) put it, the soviet authorities created different national units and put them in separate rooms within the soviet "communal apartment". The soviet authorities pursued two different goals at the same time: on the one hand they encouraged separate rooms for nations, while on the other hand they wished to boost the image of the unity of nations. The policy of encouraging nationhood was part of the so-called *korenizatsiia* (indigenisation) project, promoted in the 1920s. The aim was to spread communism and extend the popular political base among non-Russians (Pelkmans 2006, 9, 59). Thus, the soviet "landlords" strengthened and reinforced the division of nations, with the idea that the soviet republics would be national in form but not in content (Kappeler 2001, 376). Subsequently, ethnic categorisation and the establishment of ethno-territorial borders became essential in the Soviet Union. The division and administration of the Georgian SSR, containing two autonomous republics and an autonomous region, would have a critical impact on Georgia's independence (Jones 2013, 25).

In the 1930s Moscow decided to focus on developing fully-formed states, rather than pursuing numerous national projects. Many of the minor ethnic groups lost their status and therefore also their privileges, although the Georgians were among those who had their own republic and administration, and consequently their efforts towards building their national culture were upheld and strengthened. However, the “Georgian room” was far from homogeneous, and in particular ethnic minorities such as the Abkhazians and the Ossetians were oppressed within the Georgian SSR (Slezkine 1994, 426–7). The Georgian SSR had its hardships; the Great Purge in the late 1930s hit Georgian society hard, despite the fact that Stalin was Georgian. In addition many Georgians fought in the Second World War, and many of them never came back (De Waal 2010, 85–86).

An important issue in the late soviet period was a concern for the environment and natural resources. The most infamous case is the Chernobyl disaster in the Ukrainian SSR in 1986 but all across the Soviet Union environmental was receiving significant attention. Alongside issues of language and culture, environmental concerns contributed to both mobilising and legitimising ethno-political movements in the USSR (Tishkov 1997, 69–70, 77–78). It was the central authorities that made decisions regarding exploitation of natural resources, and sometimes these decisions were imposed regardless of local protest. In Georgia, there was a great protest against the proposed construction of the Khudoni dam in the Svaneti region in 1979 (Jones 2013, 29). When the central authorities decided to build the dam, protest from the local population and the new national movement, coinciding with the imminent dissolution of the Soviet Union, eventually halted the construction in 1989² (GA 2007, 9).

Georgia was considered one of the wealthiest republics in the Soviet Union, and it became a popular tourist destination known for its good food and wine (Mouritzen and Wivel 2012, 17). In the soviet period Georgia developed a busy grey economy, with extensive Mafia-like networks and pervasive corruption at all levels of society (Cheterian 2008, 157). Despite this, life in soviet Georgia was considered to be reasonably good. Georgians assumed that their country would prosper with independence as they had industry and produced good food and wine, but in fact independence turned out to be a struggle.

² In the mid-2000 the Saakashvili government decided to resume the construction of the Khudoni dam. It is one of the most controversial constructions in Georgia due to environmental concerns and the question of resettlement of local population.

2.2 A fragile beginning

Georgia experienced a severe recession after the fall of the Soviet Union. The recession had several causes. Not only did Georgia lose the money transfers it used to receive from the central authorities in Moscow, but it also lost access to an external market, which had collapsed when the Soviet Union fell. In addition, regional conflicts and unrest during the 1990s affected the country's political and economic transition (Jones 2013, 142). Like the rest of the newly independent countries, Georgia faced a double transition. First, as it evolved from a republic within the USSR to an independent state, Georgia needed to create a new institutional framework including a national, democratically-elected parliament. Second, Georgia went from a planned economy to a market-based economy. This was not an easy process, and it was handled differently across the newly independent states of the former Soviet Union (Åslund 2007, 305–307).

The first president of the newly independent Georgia, the fiery nationalist Zviad Gamsakhurdia, had a limited opportunity to introduce reforms because of the conflicts and chaos in the aftermath of independence. The conflict in South Ossetia between 1988 and 1992 and the military coup d'état that ousted Gamsakhurdia in December 1991 destroyed any serious efforts to stabilise the country. The Tbilisi-based government struggled to control the capital, let alone the country, and Gamsakhurdia was president for less than a year. While still formally in office, he died under mysterious circumstances in the Samegrelo region in December 1993 (Cheterian 2008, 204). The former soviet Minister of Foreign Affairs Eduard Shevardnadze returned to Tbilisi to become head of state in 1993. He was asked to lead a provisional government without any referendum or election, and it was not until 1995 that he was formally elected President of Georgia (Bunce and Wolchik 2011, 152).

Nicknamed “the white fox”, Shevardnadze was a skilful politician but he was hardly a reformer or a democrat. Under Shevardnadze several problems from the soviet period persisted. In addition to the secessionist regions of Abkhazia and South Ossetia, the central government had little control over Mingrelia, Samtskhe-Javakheti, Svaneti and Ajara. In addition, extensive corruption, strong organised criminal networks and the post-soviet challenges of high unemployment and rising poverty led to the government's decreasing popularity (Cheterian 2008, 210). Due to the absence of territorial unity and a functioning

central power and because of its strong regional divisions, Georgia was named a “quasi-state” or a “failed state” in the 1990s (Jones 2013, 141).

When considering Shevardnadze’s performance as president it is important to bear in mind that his starting point was a state falling to pieces due to internal conflicts. He saved Georgia from total collapse during the period between 1992 and 1993, but the state remained weak under his presidency (Cheterian 2008, 211). Bunce and Wolchik argue that Shevardnadze made “the best of a bad situation” (2011, 153). Nevertheless, the Georgian population grew impatient, being eager to see real improvements, and started to look for other political options. The already displeased population therefore reacted strongly to the fraudulent parliamentary election in November 2003 (Bunce and Wolchik 2011, 156).

2.3 The Rose Revolution

Disputes over the parliamentary election sparked widespread protests in Tbilisi in November 2003. The Rose Revolution, as it became known, led to the forced resignation of President Shevardnadze. A drawback of the revolution was yet another failure of the democratic transfer of power, as there was no presidential election and Shevardnadze was constitutionally required to step down in 2005³ (Bunce and Wolchik 2011, 149). Nevertheless, it swept a young and Western-educated politician into power and paved the way for comprehensive reforms (Jones 2013, 107). The new president, Mikheil⁴ Saakashvili, was educated in the United States, speaks fluent English and has a Dutch wife. Under the leadership of Saakashvili, the country has undergone important changes. The Saakashvili government wanted Georgia to become a liberal democracy with a liberal economy. It wanted to improve the situation for democracy, fight corruption, balance the national budget and increase economic growth. Amongst the very ambitious goals of the new government was attracting FDI to Georgia to facilitate rapid economic development (*ibid.*).

The new government led a remarkably successful fight against the pervasive corruption that has crippled Georgian leaders in both the soviet and post-soviet era (Jones 2013, 107).

³ Georgian leaders tend to assume power in an un-constitutional matter. An exception is possibly Noe Jordania in 1919 (Jones 2013, 337).

⁴ Non-Georgian sources sometimes spell the president’s name via the Russian version, Mikhail. In Georgia, the president is often referred to just as Misha.

According to Transparency International's Corruption Perception Index, Georgia has climbed in the rankings from 124th out of 174 countries in 2003 to 51st in 2012 (Transparency.org 2003). This stands in contrast to neighbouring post-soviet countries that rank much lower; Armenia ranks at 105, Russia is at 133 and Azerbaijan is down at 139 in the 2012 index (transparency.org). Noteworthy, the Georgian population and companies operating in Georgia do not consider corruption a significant challenge anymore (Gursoy 2008, 24). Corruption has been one of the most problematic legacies of the Soviet Union, and therefore, Georgia's fight against corruption represents a significant improvement.

President Saakashvili's rhetoric might be interpreted as left-wing in the Western media, even though his government has adopted some rather right-wing decisions, such as favouring big business over small businesses and employees (Jervalidze 2007, 5). The first Saakashvili government is considered the world's youngest government at the time⁵, and effectively paved the way for a new generation with an understanding of the market economy. However, a drawback was that many in the administrative bureaucracy were accused of corruption and were fired without regard to the retention and usefulness of their knowledge (Jones 2013, 166). Consequently, the bureaucracy dealt with corruption at the expense of expertise. The Georgian government has also been criticised for changing their ministers too frequently (Jervalidze 2007, 3).

The changes that have come about since the revolution can easily be observed. For instance the new glass-plated police stations symbolise modernity and transparency, and international luxury hotels in Tbilisi and Batumi represents economic growth (Jones 2013, 144). In addition, the frequent energy crises under President Shevardnadze are now gone. These positive aspects of the reforms after the Rose Revolution cannot be ignored, but it has been argued that these achievements have been made at the cost of reduction in civic and property rights (Jervalidze 2007, 10). Democracy is perhaps the area that has seen the least progress under President Saakashvili. According to the Freedom in the World report, Georgia ranks as "partly free" with a score of 4⁶, just as it did under Shevadnadze in 2003 (Cheterian 2013, 86, 106). Arguably, the willingness of the people to take to the streets to show discontent can be interpreted as a sign of strong civic consciousness. However, despite the ability to mobilise

⁵ The Georgian defense minister was twenty-nine years and the foreign minister thirty-one years old at the time of the conflict with Russia in 2008 (de Waal 2010, 196).

⁶ 7 is for most unfree, and 1 for most free countries.

and protest, as demonstrated in 2003, 2007 and 2012, Georgia's civil society remains weak (Bunce and Wolchik 2011, 323). Other democratic challenges that persist after the Rose Revolution includes that branches of power are not separated, the news media have been more constrained, the new elite holds a large share of the country's wealth and the judicial system remains dependent and flawed (Jervalidze 2007, 13). With the latter it is worth noting that many foreign companies trust the courts when they are in conflict with the private sector, but not when they have unsolved issues with the government (Gursoy 2008, 21).

2.4 The Autonomous Republic of Ajara

There were three secessionist regions in Georgia after independence. I will not go into detail about Abkhazia and South Ossetia, but I will give a short historical background and describe the central features of Ajara because this thesis looks at two greenfield hydropower projects that are both located in Ajara, and therefore it is necessary to clarify the status of this autonomous republic.

Ajara was declared an Autonomous Soviet Socialist Republic on 16 July 1921. The region had been ceded from the Ottoman Empire to the Russian Empire, but as a compromise Ajara was granted autonomy for its Sunni Muslims (Pelkmans 2006, 104). In the Soviet Union the Muslim Ajarians were not counted as a distinct ethnic group because they spoke Georgian. Moscow considered language to be a legitimate indicator for ethnicity, but religion was not (Mouritzen and Wivel 2012, 15). The authorities imposed strict control since the mountainous regions border Turkey. The republic remained a backwater of the Georgian SSR, with the possible exception of Batumi city, which was a popular tourist destination (Pelkmans 2006, 6–8, 174).

In 1991 President Gamsakhurdia appointed Aslan Abashidze to be the head of Ajara's Supreme Council. Gamsakhurdia's initial plan was to cancel the region's autonomous status, but when he eventually tried to push this through, Abashidze had already consolidated his power and was able to successfully mobilise against the president. As Gamsakhurdia faced more pressing issues elsewhere in Georgia, Ajara's autonomy was strengthened by Abashidze as he took advantage of the republic's strategic location, its seaports and cross-border trade (De Waal 2010, 146). The region's main city, Batumi, is considered to be a strategically

important asset since most of the country's cargo traffic runs through the city. Ajara did not pay taxes to the central government during the Abashidze period (Cheterian 2008, 186). However, the Rose Revolution put the status of Ajara on Tbilisi's agenda once more.

Though the events in Tbilisi in late 2003 were not directed towards the self-governing and secessionist republics, reintegration soon became an important issue (Cheterian 2008, 329). Abashidze refused to cooperate with the new central government, and the relationship between Batumi and Tbilisi worsened. The protests in and outside Ajara increased, and Abashidze eventually left the republic early May 2004. Following Abashidze's exit the new government attempted to weaken the republic's autonomy. For example, Levan Varshalomidze, a close ally of president Saakashvili, was appointed Ajara's new prime minister, and by empowering the president with the right to appoint the head of the republic, in effect Ajara became politically closer to Tbilisi. In addition, the president holds the power to dismiss the republic's legislature, which ensures that the central government retains some control over Ajara (Jones 2013, 316). Another example of the reintegration of Ajara was the decision to move the Constitutional Court from the capital to Batumi in 2007 (constcourt.ge).

Ajara still enjoys an autonomous republic status, but its power vis-à-vis central government has been questioned, since many issues are in reality decided from Tbilisi. Although Ajara can decide on some aspects of its fiscal policy, Tbilisi retains power in strategic areas, such as security and defence (Jones 2013, 316). Ajara has the same environmental and property laws as the rest of Georgia, and there are no special laws in Ajara that make greenfield hydropower projects different compared to other regions of Georgia. With this in mind, this thesis will not make a strong distinction between the Ajarian government and central government. The ministries in Tbilisi decide all the main policies and issue permits and licenses regarding the construction of hydropower plants. Currently, Ajara struggles with the same challenges as the rest of Georgia, such as a high unemployment rate and a lack of development outside the major cities (Cheterian 2013, 113).

2.5 Economic situation

The economic situation in Georgia in the year of the Rose Revolution is the subject of some debate. Some argue that the economy "was sinking", emphasising the country's vast trade

deficit and inadequate tax collection (Jones 2013, 191–192). The economist Vladimir Papava, who was the former minister of economy from 1994 to 2000, argues that contrary to common perceptions the year 2003 was relatively good (Papava 2010, 159). This was the year in which the BTC⁷ pipeline deal was signed, the GDP growth rate reached 11.1 % and inflation was relatively moderate. Yet, one of the major issues since independence remained, namely difficulties with collecting taxes from both the population and companies. When the collection of budgeted revenue failed, the country could not pay out salaries and pensions on time (Jones 2013, 192). In 2003, the estimated share of the untaxed economy in the country's GDP reached 65-70% (Papava 2005, 158). Georgia still has an uphill struggle to collect sufficient tax revenue.

In addition to some failures on the state's behalf, well-meaning advice from international financing institutions was not always suited for the Georgian reality, as for instance when the IMF suggested a new Georgian tax code in the 1990s (Papava 2005, 161). The IMF experts drafted advice on the premise that the national borders were under full control with a well-functioning customs authority, an assumption which did not reflect the actual situation in Georgia with two secessionist republics and highly active channels for smuggling goods from Russia and Turkey (Cheterian 2008, 186). Bringing in enough revenue for the treasury is a vital task. Later on, I will discuss whether hydropower production can contribute to improving revenue and income.

For the general population, the economic situation has made little improvement since the Rose Revolution. The high level of poverty is linked to the large percent of subsistence farmers and the internally displaced persons from the conflicts after independence. According to the Gini coefficient that measures inequality, Georgia in 2008 had a score of 0.404⁸, which is the highest rating of the former Soviet states (Jones 2013, 308, 120). The Saakashvili government has not been able to deal with the challenge of large and long-term unemployment patterns, poverty or the inequality.

⁷ BTC: Baku-Tbilisi-Ceyhan pipeline, transferring oil from the Caspian Sea to the Mediterranean coast of Turkey.

⁸ With zero representing full equality, and one being the highest level of inequality. The Georgian score indicate a high inequality.

2.6 Foreign policy

Another important change after the Rose Revolution was the intensified relationship with the EU and the United States and the worsening of relations with Russia. Russia was a significant importer of Georgian goods and is a key player in the question of the status of Abkhazia and South Ossetia (De Waal 2010, 197–199). While Shevardnadze's rule was characterised by a careful balancing act between Moscow and the West, Saakashvili's premiership got off on the wrong foot with the Russians (Bunce and Wolchik 2011, 105). Moscow was sceptical of the events unfolding under the Rose Revolution and feared it would lose its influence in the country (Lambroschini 2004). In early 2006 two pipelines transporting gas from Russia were blown up, leaving parts of Georgia without gas to heat their houses. To this day it is unknown who was behind the attacks, but the incidents nevertheless made Georgia recognise the need to stop relying on Russia for all its energy import (Müller-Kraenner 2008, 22–23).

2006 was also the year when the BTC pipeline started transporting oil from Azerbaijan via Georgia to Europe. The pipeline was politically initiated by the United States, though most of the investments came from Europe. With the BTC pipeline, Russia lost much of its energy influence over the region (Müller-Kraenner 2008, 93). Later the same year Russia banned imports of Georgian wine, based on dubious health concerns (De Waal 2010, 13). Other incidents followed which further damaged the relationship between Russia and Georgia, for instance, a number of illegal Georgian immigrants were suddenly expelled from Russia (Jones 2013, 248–250). Finally, the Russo-Georgian war in 2008 led to the two countries severing diplomatic relations, and subsequently Georgia declared that it would leave the Commonwealth of Independent States (rferl.org). The relationship with Russia is closely connected to Georgia's national security, and has a potential affect the decision of investors to invest in Georgia.

The EU has become more active in Georgia since 2004, even though the prospect of accession remains ambiguous (Mouritzen and Wivel 2012, 147). The EU has given a great deal of support for state building through different organisations. Moreover, the United States has also been involved in democratic development both before and after the revolution (Bunce and Wolchik 2011, 239). The Georgian government has stated that it aims for full EU

membership⁹, although this is unlikely to happen in the foreseeable future. At present the Georgian government has settled for political agreements and convergence with EU standards and regulations. Since 2006 Georgia has been a member of the EU's European Neighbourhood Policy (ENP), a fact which has affected several policy decisions, such as security issues and market reform (Mouritzen and Wivel 2012, 156). Another foreign goal is NATO membership; something which Russia strongly opposes (Jones 2013, 251). Also worth mentioning is Georgia's relationship with neighbouring Turkey, since Georgia and Turkey have expanded their political and economic collaboration since the Rose Revolution.

2.7 Summary

The aim of this chapter has been to describe the political and economic situation in Georgia, since the nation's political orientation, economic situation and civil society are important aspects that have an impact on the hydropower sector's development. The chapter has described the current state of the country and pointed out some of the persistent challenges, such as collecting revenue, a weak civil society and a high unemployment rate. Not long ago the country was in chaos and decline, but Georgia has clearly come a long way in a short time. In addition, the successful reintegration of Ajara should be noted. To understand the role of FDI in Georgia we need to understand the post-soviet transition as well as the current political and economic situation.

⁹ Devotion to the EU can be seen outside the Parliament in Tbilisi. Next to the Georgian flag, flies the EU's flag.

3 Methodical and theoretical framework

This chapter will present the methodical and theoretical framework of the thesis. First I will describe the method of the research, before moving on to examine the theoretical framework and tools that will be used throughout the thesis.

3.1 Method

This chapter describes the research method I have chosen as well as the procedure for data collection. This thesis is a case study of two greenfield hydropower plants in Georgia. The method used in this thesis raise some challenges, which are discussed below.

3.1.1 Qualitative methods

There are multiple definitions of qualitative methods. In this thesis I will employ Ragin and Amoroso's classification of a qualitative method as a "basic strategy of social research that usually involves in-depth examination of a relatively small number of cases" (2011, 230). I have chosen to use a qualitative research approach because the aim of the thesis is to understand the context and obtain a deeper knowledge of greenfield FDI in the Georgian hydropower sector. I want to look beyond a purely quantitative understanding of Georgia's hydropower development. As such, a qualitative approach was an obvious choice. The aim of the thesis is not to prove a "grand theory", but rather to gain an in-depth understanding and develop ideas based on the empirical findings (Ragin and Amoroso 2011, 113).

As I gathered information, I realised that there was limited material available that projected how FDI in the greenfield hydropower sector would affect Georgia. Apart from general statements, the government has no public plan for how Georgia will profit from the greenfield investment in the electricity sector. Most of the literature is written with potential investors in mind, including reports from organisations such as the World Bank, the IMF and the USAID. The reports are written for and from an investor's point of view, and therefore they do not always consider the consequences for the country as such. In addition, the memorandums

between the government and the investing foreign companies are confidential. Consequently, little concrete information can be retrieved from such documents. As a result, I recognised that it would be useful to interview different stakeholders in order to obtain information that would enable me to answer the questions in the thesis. The stakeholders in this context are the Georgians who are affected by the greenfield development, ranging from the authorities and the private hydropower companies to the NGOs and members of the local population who are directly affected.

3.1.2 Case studies

In the early stages of the research it became evident that a case study methodology would be suitable for the thesis. Yin writes that “a case study is an empirical inquiry that investigates a contemporary phenomenon in depth and within its real-life context, especially when the boundaries between phenomenon and context are not clear” (Yin 2009, 18). Thus, by looking at the context and circumstances related to the two cases studied, I seek to gain an in-depth understanding of the issues discussed in this thesis.

More importantly, the case study is a good option when using multiple data sources (Yin 2009, 114), which is useful since this thesis draws upon a range of different empirical data. The data sources utilised include interviews, news media, government resolutions and various reports from local and international NGOs. During the analysis I will draw on different data sources and see if there are corroborating results. If so, this might strengthen the findings (Yin 2009, 116). The combination of multiple sources of data is called triangulation, which means “to collect converging evidence from different sources” (Yin 2011, 79). Such a technique contributes to a broader understanding of the data, and can make the analysis more robust (Yin 2012, 13). Triangulation of data might enhance the validity of the research since multiple sources of evidence provide support for the existence of the same phenomenon (Yin 2009, 116).

I wanted to avoid pinning all the resources on one single case, which can be a weakness of single-case studies (Yin 2009, 61). Examining two cases will reduce the risk of overlooking or overestimating certain issues. Arguably, more cases could have been added to the analysis in the thesis, but I believe that the two cases chosen provided enough information about the

subject under investigation. In addition, the thesis does not seek to generalise the results in a broader sense. The findings reported in this thesis might not be well suited for generalisation; rather, the aim is to contribute to the understanding of the role of FDI in greenfield hydropower in the particular context of the two cases. The findings can therefore offer insights into the specific context under investigation.

3.1.3 Positionality

In the spring of 2012, I undertook an internship with the AGL project in Batumi. The internship lasted for approximately five months and was part of my master's degree. Through the internship I gained useful insights into the political and economic situation in Georgia in general, and the hydropower sector in particular. As the case study methodology usually requires previous knowledge (Yin 2009, 72), it was an advantage to have worked in the AGL project, thus gaining first-hand experience in the country and the hydropower sector. This made my research trip to Georgia easier, while also enabling me to ask the stakeholders better and more specific questions. Also, I believe that the internship gave me better access to the stakeholders I wanted to contact. That said, Georgia after the Rose Revolution is considered to be one of the most open post-soviet societies, making it easier to gain access to some stakeholders (Cheterian 2013, 91). This openness is reflected in Transparency International's Corruption Perception Index, where Georgia was one of the most corrupt countries in 2003 but has now climbed to a respectable 51st place (transparency.org). Although my previous experience was certainly an advantage, it is nevertheless true that even with such experience it would have been more challenging to conduct similar a research in neighbouring Russia or Azerbaijan, for instance, which are far less open countries than Georgia.

However, while the stay provided me with knowledge about the hydropower sector in Georgia, it also gave me a certain bias. It is undoubtedly true that there is no such thing as absolute objectivity when writing a qualitative thesis, but this is not necessarily a goal of such studies. Still, it is worth mentioning that case studies might be more prone to the problem of bias, because they usually demand previous knowledge of the issue being studied. As some bias is inescapable, it is necessary to be aware of them and to remain open to contrary empirical findings (Yin 2009, 74). My close relationship with the AGL project might have given me a certain bias, and therefore I want to be open about that in principle I am in favour

of hydropower plants, and in general, I have a positive opinion about both the project cases, although I recognise that hydropower construction might have social and environmental drawbacks. By being open about my views, I hope that the reader will detect whether there is any bias in my research (Yin 2011, 39).

3.1.4 The interviews

The analysis is based on interviews conducted with different stakeholders within the hydropower sector in November 2012. The thesis puts greenfield FDI in a broad political and economic context, but the extensive scope of the related issues means I cannot go into detail about every aspect of the data. I found interviews to be the most useful approach in order to understand what the stakeholders regard as the main issues.

I conducted eighteen interviews, three in Batumi and the rest in Tbilisi. The country has become centralised after the Rose Revolution, meaning that the capital is the place to get hold of important stakeholders, although Batumi and Ajara are where the hydropower construction is taking place. Ajara has legal status as an autonomous republic, but this makes little political and legal difference (see the discussion in the previous chapter). In Batumi I mainly gathered specific information on the cases, whereas in Tbilisi I got both general background information and specifics related to the cases.

I conducted the interviews in a semi-structured way; that is, I had a set of questions but I kept the interviews open so the interviewees could express themselves more freely. Semi-structured interviews allow flexibility and are open to the possibility that the informant might bring up points or topics that otherwise could be missed (Yin 2011, 135). Hence, this interview format is ideal for qualitative explorations of previously unexplored subjects.

I took notes during the interviews and wrote them up on the same day that the interviews were conducted, in order to minimise the risk that I would forget something vital. Two interviews were carried out with the help of a translator and the rest were conducted in English. I could have done the interviews in Russian, but a translator was provided and I felt it would have been impolite to turn them down. The translators had a good knowledge of English, but nevertheless there is always a risk that some nuances might get lost in translation. However, speaking and writing Russian helped with getting around and with making contact with

people, and Georgian platitudes helped as well. All but one interview were done in the offices of the interviewee, and they lasted between thirty and ninety minutes.

As I had some previous knowledge of the hydropower sector, I had an idea of who it would be useful to interview and I started with contacting those people. Then I used snowball sampling, asking my informants if they had any suggestions for stakeholders I should talk to. I tried to aim for a balance between different kinds of stakeholders. Also, by interviewing a range of stakeholders I was trying to detect bias and hidden interest of the interviewees.

The stakeholders had different views on the hydropower sector. I had one or more interviews with participants from the following areas: a private hydro company (Adjaristsqali LLC), a private scientific research firm (Gamma Consulting), two local environmental NGOs (Green Alternative and the Greens Movement of Georgia), a regional environmental NGO (Caucasus Environmental NGO Network), an international NGO (Transparency International Georgia¹⁰), an employee at the Energy Efficiency Centre, an associate professor at Tbilisi State University, an independent energy expert, a state investment agency (Invest in Batumi), an employee at a centre promoting the Aarhus Convention (the Aarhus Centre Georgia¹¹), a former vice minister at the Ministry of Environment Protection, a civil servant from the Ministry of Environment Protection, two civil servants at the Ministry of Energy and one interviewee who wished to remain anonymous. Additionally, I had a telephone interview with the PR manager at the Ajar project in March 2013. For all the participants I will refer to their position and workplace, but I will not use their names since I assumed that the stakeholders answered according to the policies of their company, ministry or organisation. Their statements, unless otherwise noted, are therefore not to be interpreted as personal opinions, but rather as an expression of the stakeholder organisation's view. All the interviewees were Georgians. In addition to the interviews, I also attended a public meeting with the Ministry of Environment Protection, a presentation on tariffs by the Norwegian hydropower economist Einar Hope, in which the tariffs in Georgia were discussed, and I also talked to several expatriates living in Georgia who working for different international companies and NGOs.

¹⁰ I meet with Transparency International Georgia three times, including meeting with one property expert, a lawyer on the more general features, and a meeting at the Batumi office.

¹¹ The Aarhus Centre was established to facilitate the implementation of the Aarhus Convention in Georgia, and works to implement the three pillars of the convention; "promote access to environmental information, public participation in environmental decision-making and access to justice" (aarhus.ge).

A group of stakeholders I did not interview during my research trip to Georgia was the affected population. In the spring of 2012, however, I travelled to the areas affected, and I spoke with the local population, which provided me with some idea of the issues that concern them. The affected population's reflections are of course interesting and relevant, since they are the ones who are primarily affected by the developments. For various reasons I did not formally interview the affected population, and to mitigate this weakness I will address the concerns of the affected population by other means. It has been very useful to utilise the records of public meetings from several different hydropower projects, and the data from both cases contain thorough reports from public meetings with the affected population. These documents are publicly available and they demonstrate the questions and concerns of the people present at the meetings. In addition, I have also utilised accounts from NGOs, although I am aware that the NGOs might have their own agendas. A recurring problem seems to be that the affected population tends to be inadequately informed about the project status and the consequences of the hydropower plant. This leads to speculation and scepticism among the population (GA 2012a, 14). Additionally, the construction of the hydropower plants has just begun, and the consequences of the schemes are not yet completely evident. Thus, the analysis is based on the plans and actions of the companies and the Georgian authorities up to 2013, and less emphasis is placed on what the affected people feel they have gained so far.

3.1.5 Other factors

The interviews were done a month after a parliamentary election in Georgia, an election which was won by the opposition. During that time the ministers and some of the government officials had been replaced, so when choosing interviewees at the ministries it was vital to make sure that the participants had been in their posts during the years relevant to this thesis (2006 to 2013). The only interviewee that requested to remain anonymous said that someone might call her the day after the interview and offer her a government position. Although there had been no post-election unrest, I felt that there was nevertheless a sense of tension. There was also uncertainty concerning the new parliament's position on hydropower. Some of those I interviewed seemed more concerned with guessing what would happen next than reflecting on the recent past.

Regarding the names of places, I will use the Georgian official English names, reflecting how Georgian authorities spell place names in official documents and web pages. Therefore, I will use Ajara and Abkhazia rather Adjara and Abkaz. Many cities and rivers mentioned in this thesis have Georgian, Turkish and Russian equivalents. As the thesis does not seek to explore the relationships between the neighbouring countries, I do not consider it problematic to use the Georgian versions. Some Georgian scholars spell their names differently in English. In such cases I have used the name that occurred most frequently when searching online. This may not always correspond to the correct way of transcribing from Georgian to English, but it makes the research easier to track, which is good for the validity of the study.

3.2 Theoretical framework

In this section I will identify the broad theoretical approach that will be used in the thesis. The section will start with a discussion of the post-soviet theory, followed by an examination of the concepts of neoliberalism and the Washington Consensus. The aim is to give a background to the ideas that have influenced Georgia's policy path after independence, and especially since the Rose Revolution. In addition, I will use the World Bank's Ease of Doing Business Index and the OLI paradigm (see page 35–37 for a description of OLI) as analytic tools to help answer the research question.

3.2.1 Post –soviet theory

With the fall of the Soviet Union, Soviet/Russian experts had a temporary setback in their academic discourse since they had failed to foresee the collapse. The new situation also opened for new research input, and several non-regional experts jumped in to fill this demand (Engerman 2009, 337). Economists, bankers and financiers gained influence at the expense of historians and political scientists (Wedel 1998, 4). The former group primarily consisted of economists such as the Harvard-based Jeffrey Sachs. These scholars had little expertise in the post-soviet field; instead they based their advice and recommendations on economic experiences from Latin America and Southeast Asia (Åslund 2007, 30).

The issue at stake was how the post-soviet states would catch-up economically and politically with Europe and the United States, and the pace of reform was at the very centre of the

debate. There were two camps engaged in discussing this question: some supported the introduction of rapid reforms, while others wanted a more gradual approach. The supporters of rapid reform can themselves be divided into three groups (Åslund 2007, 31). First, there were international financial institutions and some Western governments. This group primarily consisted of the IMF, the World Bank and the government of the United States, and they provided aid in the form of financial loans (Wedel 1998, 25). Second, there were the leading Western economists, for example Jeffrey Sachs, David Lipton, and Lawrence Summers. These economists were primarily Americans from top universities (Åslund 2007, 31). Several of them acted as advisors to the government, providing technical assistance and financial advice. Third, there was an often overlooked group of Eastern experts, such as the Czech Republic's Vaclav Klaus and Poland's Leszek Balcerowicz. These politicians showed that ideas about radical reform also came from countries in transition, rather than only imposed by Western-based institutions and experts (Bandelj 2008, 64). Those in opposition to radical reform, the so-called gradualists, constituted a group whose ideas were less clearly defined. Their main argument was nevertheless that a rapid transition would be socially costly and trigger an initial recession. For them, the gradual and successful economic reform of China was a source of inspiration (Åslund 2007, 37).

Janine Wedel, an anthropologist who followed the post-soviet transition, writes that the debate about rapid versus gradual reform occurred mostly in academic circles, but Western financial agencies largely supported the former approach (1998, 21). Several of the newly independent states chose a form of radical reform, often referred to in this context as "shock therapy". The interpretation of the political platform of shock therapy is controversial. Some observers say that shock therapy was solely the recommendation of international institutions and Western governments, while others argue that it might have been influenced by the recommendations of the aforementioned group, but the implementing countries took it a step further (Robinson 2013, 24). Nonetheless, shock therapy promised to tackle economic transformation without first building up new institutions to implement the reforms (Robinson 2013, 26).

In his book entitled *Understanding Post-Communist Transformation*, Rose writes that ignoring the past can easily lead to a misunderstanding of the present (2009, 9). He notes that at the start of the transition period there was little talk about the suitability of post-soviet

societies for embarking on a capitalist path. The legacy of the soviet past was ignored in favour of the shock therapy approach to creating a market economy (*ibid.*, 47). The recommendations given were in general based on abstract models that often avoided facts which did not match the prescribed model (*ibid.*, 70). Most of the recommendations were based on neoliberal economic theory, which will be discussed later in this chapter.

The transition reforms did not solve all the problems, and they also created new economic challenges, such as hyperinflation and a skyrocketing unemployment rate (Åslund 2007, 47). The rapid reforms proved both politically and economically difficult. Politically, the government in the 1990s lacked de facto power, largely due to neoliberal policies that aimed at less government influence. Economically, the soviet legacy was too entrenched, with reforms proving easier to implement in Eastern European countries that had been less marked by their soviet past (Robinson 2013, 29). While the break-up of the Soviet Union gave an extraordinary opportunity for comprehensive change, it did not provide a chance to start over with a clean slate. However, most of the advice on political and economic issues ignored the role of the communist legacy (Wedel 1998, 137).

Georgia's is perhaps one of the unhappiest post-soviet stories, since the country did not only suffer deep economic recession but also experienced a civil war. The conflict further damaged the economic situation as it delayed reforms and macro-economic stabilisation (Åslund 2007, 26). Economic growth first started in 1995 after the end of the worst conflicts (Auty and De Soysa 2006, 97). Georgia opted for market reform in the early 1990s, but the reforms introduced were more or less a replica of what had been done in Russia, and as in the Russian case, they turned out to be unsuccessful (Papava 2005, 125). Jones writes that by 2003 Georgia was considered to be one of the biggest reform failures out of all the former soviet cases (2013, 191). The reforms had not been able to control the country's substantial trade deficit, and neither had the nation attracted any sizeable FDI. In addition, the state was still dependent on Russian energy imports. Some scholars, such as Åslund, argued that the failure was not due to misguided policy, but because of the lack of comprehensive reform or failures of implementation (Åslund 2007, 57). Stiglitz, on the other hand, argued that the reform failure was due to the economic approach itself (Stiglitz 1999, 3). The following section provides a closer look at the theories that informed Georgia's transitional phase, as well as today.

3.2.2 Neoliberalism and the Washington Consensus

Neoliberalism is an economic theory that advocates strong property protection, a free market and free trade. It favours big business and promotes the downscaling of government (Harvey 2005). In the late 1980s and early 1990s the theory was a popular economic framework. On the basis of experiences from Latin America in the 1980s, several macroeconomists, the IMF, the World Bank and the government of the United States all believed that macroeconomic stabilisation could best be achieved through radical and comprehensive reforms. Lawrence Summers, chief economist of the World Bank in 1991, illustrates the mood with the following quote: “spread the truth – the laws of economics are like the laws of engineering. One set of laws works everywhere” (Rose 2009, 2). The mood of the time among economists and politicians was that there was indeed a recipe for economic development that fitted all countries, no matter where they might be or what their background was. By following the neoliberal approach, all countries could experience economic growth.

A term closely linked to neoliberalism is the Washington Consensus, which was coined by the economist John Williamson. This concept draws on neoclassical economic theory with an emphasis on free-market capitalism. The consensus is not an official policy or a position taken by any government or organisation. Rather, it is a set of policies agreed upon to an extent that it can be considered a consensus (Kolodko 2001, 312). The consensus consists of ten rather general points, such as “financial discipline is needed”, and promotes the virtues of a “liberal foreign policy” (Craig and Porter 2006, 58).

The Washington Consensus is often used as a set of ideas, and thus a broad definition will be used in this thesis. According to Williamson, the Washington Consensus attempted to summarise policies that viewed the key to economic development as depending not on natural resources or human capital, but rather on the economic policies that the country pursued (Craig and Porter 2006, 58). It represented a paradigm developed at a time when most economists pursued a certain development strategy and many had little patience with nuances or doubts, believing that those who stood against reforms had the intention of preserving the status quo (Craig and Porter 2006, 58–59). The Washington Consensus and the reform policies inspired by the IMF and the World Bank relied, and still do to some extent, on the theory of the perfect market, but the post-soviet countries a long way from this ideal model

(Jomo and Fine 2006, 27). Financial lending from institutions such as the World Banks and the IMF is called “assistance”, but this term may be misleading, since the loans are commercial with tough repayment terms (Kolodko 2001, 307).

In broad terms, the Washington Consensus holds the view that FDI accelerates economic growth. Barriers to FDI should be removed, and foreign and domestic companies should compete on equal terms (Kolodko 2001, 309). By presuming that multinational companies offer spillover effects in one form or another, the consensus values the quantity of FDI over its quality (Lall and Narula 2006, 5). Thus, it has a simplistic approach to the question of FDI. Concerning the greenfield hydropower plants, they can improve productivity and generate more exports, but that does not automatically mean that the industrial capacity or the competitiveness of the domestic sector will increase. Ultimately, the two latter factors are vital for sustainable growth (Lall and Narula 2006, 15).

In the early 1990s the policy towards emerging markets, such as that in Georgia, was shaped by the Washington Consensus, which promoted financial and trade liberation as the key to growth and prosperity. The newly independent states were encouraged to liberalise as quickly as possible (Miller and Zhang 2001, 37). One of the conventional wisdoms of the Washington Consensus was a belief in free trade. This faith in free trade is still unquestioned (Jomo and Fine 2006, 47–48). I will not discuss the empirical literature on free trade but rather state that Georgia has followed a liberal free trade regime since the Rose Revolution.

Several politicians and economists in the East were also influenced by these theories (Åslund 2007, 31–32). The Washington Consensus is often named as the model for post-communist countries. While this might be true, some of these countries took reforms further than the consensus had anticipated, implementing more radical and specific programmes than the IMF and the World Bank had suggested (Stone 2002, 91). The IMF, the World Bank and the United States have been active in Georgia since independence, and have had an influence on the country’s policy path. Neoliberal policies were pursued both before and after the revolution in Georgia, but they accelerated after the Rose Revolution.

Some of the post-soviet states have the “four Asian tigers¹²” as a role model, and the economic achievements of the Southeast Asian countries have been credited to neoliberal policies (Gregory, Johnston et al. 2011, 38). It is true that the tigers’ growth has been fuelled by FDI to a large extent, nevertheless challenges have also arisen as a consequence of their economic development (economist.com). Therefore the tigers should not only be a model for economic growth but should also serve as a lesson on the importance of sustainable development. President Saakashvili has an ambition to “turn Georgia into a real flagship of the world liberal economic ideology” (civil.ge). It is apparent that the Saakashvili governments have followed a neoliberal influenced policy path (Schueth 2011, 64).

Many have criticised the scope of the Washington Consensus, with one of the major criticisms being the lack of attention paid to institutions (Kolodko 2001, 310). Former Polish Finance Minister Grzegorz Kolodko argues that “a lack of institutional development turned out to be the missing element in transition policies based on the Washington consensus” (Kolodko 2001, 310). Rose (2009, 73) also argues that another mistake was the belief that national governments or international organisations like the IMF could be in real control of the transition process. According to Kolodko, transitions cannot be executed rapidly because introducing new laws, new institutions and new behaviours takes time (Kolodko 2001, 305). Craig and Porter (2006, 55) write that the Washington Consensus was “unattractive in name, unloved and often regretted in practice”. Both the IMF and the World Bank were heavily criticised because some of the countries that followed the reform programme showed poor economic performance (Jomo and Fine 2006, 29). The time for change had come.

3.2.3 Beyond neoliberalism?

The neoliberal approach has changed since the 1990s – or rather, and perhaps more importantly, the position of the World Bank and the IMF has changed. Instead of concentrating on structural adjustments, the focus has shifted to include poverty reduction and the promotion of good governance (Craig and Porter 2006, 1–3). When compared to most other international financing agencies, the World Bank has given more attention to social issues, and it has embraced a more “socially inclusive” version of the Washington Consensus. Also, since 1999 the World Bank has focused on a broader approach to development,

¹² Refers to the following developed economics with years of high growth rates; Singapore, Hong Kong, South Korea and Taiwan.

including social and environmental considerations, instead of only emphasising economic adjustments (Kolodko 2001, 317). The narrow focus on economic adjustments was no longer sufficient, and development had to include other aspects such as sustainability. This is often referred to as a post-Washington Consensus (Jomo and Fine 2006, 33).

Nobel Laureate Joseph Stiglitz is associated with the post-Washington Consensus, which acknowledges that institutions, history and social conditions matter. Stiglitz has often criticised IMF policies; in particular, he has criticised the privatisation scheme in Russia (Hoff and Stiglitz 2002, 8–9). Stiglitz has argued for an “alternative paradigm, especially one relevant to the least developing country”, claiming that earlier development approaches had failed because they had viewed “development too narrowly” (Stiglitz in Jomo and Fine 2006, 9). However, Stiglitz did not break with the Washington Consensus; rather, he made the approach more nuanced and added to the scope of its theoretical framework. Thus, the post-Washington Consensus builds on the Washington Consensus in many respects (Jomo and Fine 2006, 15).

Jomo and Fine (2006, 35–36) write that some of the World Bank’s current policies are proof that the Washington Consensus approach is still very much alive. With the Bank stating that there is little use in giving money to countries with “poor policy”, the conditions to receive financial aid are linked to the macroeconomics of the Washington Consensus – for example, low inflation and trade openness (Jomo and Fine 2006, 35–36). The main conclusion of the post-Washington Consensus is that institutions are vital to a country’s progression towards durable growth (Kolodko 2001, 323–325). More scholars have been looking at the role of institutions, and several of these people are from academic backgrounds other than economics (e.g. Wedel 1998; Rose 2009).

The World Bank has aspired to take a leadership role in economic development around the world. As described above, the World Bank has changed its focus from stabilisation and structural adjustment under the Washington Consensus to a broader approach that includes environmental issues, institutional reform and “good governance” (Jomo and Fine 2006, 21). The World Bank has been active in post-soviet countries, including Georgia, where it has been instrumental in the initial transition period as well as involved in projects to increase standards of living (Kolodko 2001, 317). Through the IFC the World Bank has fiscally

supported one of the two cases in this thesis, and this has influenced the company's policy, as will be discussed later. The next section contains an example of how the World Bank has influenced Georgia's policy path.

3.2.4 The World Bank's Ease of Doing Business Index

The World Bank's Ease of Doing Business Index (EDBI) is a global indicator of economic competitiveness. It evaluates and ranks countries according to business regulations. The Doing Business project promotes a "one size fits all" policy (World Bank and IFC 2004), meaning that it is a model that can be applied to all countries across the world when it comes to competitiveness (Schueth 2011, 61). It is a part of the World Bank's efforts to reduce poverty and promote development (Davis and Kruse 2007, 1098). The EDBI suggests that countries should aim for particular targets in order to enhance competitiveness, and the index collects quantitative data on 185 countries. The EDBI deals with a broad set of business activities: starting a business, hiring and firing employers, getting credit, closing a business, registering property, paying taxes, trading across borders and dealing with licenses (Davis and Kruse 2007, 1097). The ranking takes a top-down approach, where the World Bank sets the benchmarks and countries are ranked accordingly. It provides an external stimulus for Georgia's policies because Georgian politicians are keen to climb the index, and consequently the World Bank exercises influence on the country's policies.

The Georgian government has used the EDBI as a strategic tool for deregulation and liberalisation. For Georgia, the country's continuing climb up the rankings has been a "benchmark of its progress" (World Bank and IFC 2007, 7). In 2006 Georgia targeted a place in the top twenty-five countries, and it managed to reach this goal two years later. By 2013 Georgia's rank has climbed three places from the previous year and is now in the top ten, being ranked in ninth place out of 185 economies (doingbusiness.org 2013a). Interestingly, Georgia is categorised as a lower middle-income country, whereas the rest of the countries in the top ten are considered high income countries. The next lower middle-income country is Armenia ranked at 32 (*ibid.*).

These achievements have improved Georgia's reputation from "a failed state to a neoliberal vanguard state" (Schueth 2011, 62). Furthermore, the results have been quoted in

international commercials worldwide (georgia.gov.ge 2012). Thus, Georgia has utilised the potential of the country's favourable EDBI ranking. By following the benchmarks set by the World Bank, Georgian politicians have relied on what the Bank's economists believe works best to promote business (Fougner 2008, 321). At the very top of the ranking is Singapore, often mentioned by President Saakashvili as the ideal model for Georgia (civil.ge).

A criticism against the index, similar to criticisms of neoliberalism, is that it does not consider factors in the countries' social and economic contexts. In the EDBI the states are only judged in terms of their economies, with the prime attribute being competitiveness (Schueth 2011, 57). Although the World Bank itself has become more orientated towards social issues, the index is an exception to this development. Fougner (2008, 303) warns against viewing competitive international rankings as neutral sources of information about the economic conditions of countries worldwide. Rather, they should be viewed as efforts to govern states in accordance with the neoliberal rationale. The policy is often favourable for private companies and capital flow (*ibid.*, 304).

Kolodko (2001, 315) writes that one of the failings of the early Washington Consensus was that there was little distinction between the tools and the goals. For instance, he argues that stabilisation and deregulation are nothing more than policy means, while sustainable growth and a better standard of living are the goals (*ibid.*). Though tools can in theory promote efficiency and competitiveness, it is not certain that this will occur in practice. Some of this might be true for the relationship between Georgia and the World Bank's EDBI. It is a useful tool for following a certain reform path, but Georgian politicians seems to value it more than that. As such, the politicians might be at risk of making the same mistake as the reformers in the 1990s. Reaching the top ten should not be the end goal; the focus should be on the outcome of climbing the index, not merely climbing as high as possible. The ranking will be used throughout this thesis as a tool to demonstrate how reform-friendly Georgia is, and will also be used to illustrate that reforms are not always suitable or helpful for the Georgian reality. It also serves to illustrate that Georgia has been influenced by a neoliberal "one-fits-all" policy.

3.2.5 The FDI debate

This section will discuss the literature on FDI and economic development, as well as FDI's impact on environmental issues. FDI has been at the core of mainstream economic theory for years, and international organisations such as the IMF and the World Bank have had high hopes that FDI will trigger economic growth in emerging economies. Often these organisations have measured the level of success based on the total value of FDI inflow, placing emphasis on quantity (Neuhaus 2006, 39–40). A 2002 report from the OCED claims that “the overall benefits from FDI for developing countries are well documented” (Zarsky 2005, 21).

However, there is no evidence that FDI automatically leads to economic growth. In the book entitled *International Investment for Sustainable Development* the author argues that FDI is “no miracle drug” (Zarsky 2005, 15). Rather, it is shown empirically that the results of FDI in developing countries can turn out to have either a neutral or a positive impact on economic and environmental development. FDI might have the theoretical potential to generate growth, but the investment climate still has to conform to the “right” conditions. In short, these conditions include a certain level of human and technical development, functional institutions and some degree of the rule of law (Zarsky 2005, 26). Consequently, it is not simple to predict the likely outcome of FDI, since it is dependent on several factors (Moran, Graham et al. 2005, 197). Indeed, empirical evidence suggests that FDI's effects on economic growth have ambiguous results, and there is little reliable evidence supporting the claims that FDI will necessarily accelerate economic growth (Charles 2000, 9; Moran, Graham et al. 2005, 197; UNCTAD 2009, 12–14).

There are two main camps in the literature debating FDI and development. On the one hand, there are those who believe in free-market capitalism, who assert that FDI is indisputably beneficial and the more a country attracts the better. Neoliberalism recommends FDI, since it is considered to be “the highest form of external finance, ahead of portfolio investment, commercial loans, or overseas development aid” (Schueth 2011, 56). On the other hand, there are scholars critical of the notion of FDI-driven development, who point out that “one dollar of FDI is worth no more (and no less) than a dollar of any other kind of investment” (Dani Rodrik in Moran, Graham et al. 2005, 281). These authors are sceptical of the uncritical use of

FDI as a main tool for development (Inadomi 2010, 4). If the quest to attract FDI fails to deliver positive results, then the government should be worried about their responsibility and the cost of the FDI (Kolodko 2002, 4). The inflow of FDI should be seen as an addition to the flow of domestic capital, not as an alternative. Narula and Lall (2004, 15) write that the neoliberal approach to FDI gives few realistic answers. One of the critical questions is whether FDI promotes or lowers environmental standards (Dunning and Lundan 2008, 312).

The relationship between FDI and environmental policy has gained increasing attention in the last two decades (see e.g. Zarsky 2005; Haas 2003; Viuales 2012). The notion that multinational companies seek “pollution havens”, as sometimes depicted by NGOs and the media, is in some cases true and in others not. Multinational companies sometimes attempt to transfer their high environmental standards throughout their subsidiaries (Zarsky 2005, 49). In some instances, the multinational companies have higher standards than their domestic counterparts. The improved environmental standards of international companies seem to be a result of wanting to be labelled as environmentally friendly businesses, rather than of regulatory pressure (Bulcke and Verbeke 2001, 5–6, 59). Shareholders might withdraw from projects with an appalling environmental management record, and therefore shareholders can influence the companies’ environmental policies. In addition, a good environmental policy might be part of a strategy for gaining and maintaining good relationships with the local population (Bulcke and Verbeke 2001, 60–61). The next section will look at a theory which tries to explain why some companies choose to invest in certain countries, namely the OLI paradigm.

3.2.6 The OLI paradigm

A scholar who has made a comprehensive contribution to the understanding of FDI is the British economist John H. Dunning, known for the OLI paradigm where he combined three theories of FDI. Dunning drew upon existing ideas on company theory, location theory and theories on industrial organisation and the market in order to create a better approach for understanding why some companies choose to engage in FDI activities (Maitland and Nicholas 2003). The paradigm identifies three categories of so-called advantages, namely ownership (O), location (L) and internalisation (I) (Dunning and Lundan 2008, 100). The three categories are sometimes also defined as why? (O), where? (L) and how? (I). It is a

framework for analysing international companies' strategy and performance, without having to rely on FDI statistics (Eden 2003, 279). The OLI paradigm can also be used as a tool for analysing the host country's determinants for attracting FDI (UNCTAD 2009, 5).

The ownership (O) factor deals with the management advantages of the international company. It seeks to answer the question of why companies chose to become investors abroad and what advantages the companies must possess in order to succeed at this. Advantages for natural resource-seeking investors might include bargaining strengths and management expertise (Dunning and Lundan 2008, 104). Closely linked to the ownership advantages is the internalisation (I) advantage. Internalisation aims at explaining how the company utilises their ownership advantages in practice, and explaining why companies choose to own production rather than, for instance, producing in a joint venture (Eden 2003, 281). These two factors are internal and are directly related to the foreign investor company (Neuhaus 2006, 142).

An external factor is the location (L), the "where" of the FDI, referring to the location advantages of the host country (Gugler and Dunning 2008). Such advantages might include government policies that affect FDI inflow, e.g. the removal of barriers to entering the market or to the import and export of products. Other factors may include tax benefits and low wages (Dunning and Lundan 2008, 104). Maitland and Nicholas believe that the O and I advantages are specific and useful analytic tools for understanding business decisions, while the L advantage is reduced to a list of contextual factors (2003, 49). Nevertheless, in this thesis the L component is relevant to Georgia as a host country trying to attract FDI, and it will be useful for explaining the reforms introduced by the government, as well as in examining why the case study companies have invested in that particular country. Location advantages in Georgia include an untapped hydropower potential, low wages and low taxes (investinbatumi.ge).

The OLI paradigm indicates how ownership factors, combined with location and/or internalisation advantages, affect a company's investment decisions. In order for a company to decide if it wants to be involved in FDI, it must achieve a net gain within one or more of these categories (Gugler and Dunning 2008). Dunning and Lundan (2008, 102) suggest that the three advantages are interdependent with one another, and that together the three aspects of the OLI paradigm interact to explain a company's decision to invest in a specific location.

Dunning argues that the patterns of FDI are not regular, but differ according to the three elements (Dunning 1998).

Eden believes the OLI paradigm should be viewed as “a way of looking at the phenomenon of multinational enterprises and their activities” (2003, 277). The paradigm operates mainly from the investing company’s perspective, but nevertheless it is useful to understand the preconditions of investment in a world where several countries are competing to attract FDI. The paradigm enables me to analyse the political features of the host country and the difference between that companies. In contrast to research on international business that tends to solely focus in the company, the OLI paradigm might say something about the country-company relationship (Maitland and Nicholas 2003, 52). In this thesis the L component will be used as a tool to interpret FDI in Georgia’s hydropower sector, whereas the other two factors (O and I) can be used to explain the different outcomes of the two cases.

3.3 Concluding remarks

In the first part of this chapter I discussed the choice of method and argued that a qualitative approach is the most suitable for the aim of the thesis. The advantages and potential drawbacks of the methodological choice are mentioned, regarding the latter, I have tried to acknowledge and minimise any disadvantages of the qualitative method chosen, such as bias.

The second part deals with the theoretical framework of this thesis. Neoliberal ideas have influenced many of the newly independent states, including Georgia. After the Rose Revolution the tendency towards neoliberal policy became clear, shown for instance in President Saakashvili emphasis that Singapore is a model for Georgia. As discussed above, the World Bank has had a considerable influence on the country’s policy path. It also has a direct influence on the company policy of one of the cases, namely the AGL project. I will use the EDBI as a tool for analyse the policy choices of the government. Though the ranking may say something about how reform-friendly a country is, it is not certain that an exclusive focus on the ranking is the most suitable approach. The OLI paradigm will help to analyse the findings in the thesis, explaining why the country has attracted FDI.

4 Energy policy and FDI in Georgia

This chapter will discuss the characteristics of the hydropower sector in Georgia, in particular how Georgia made itself an attractive location for hydropower investment (the L in the OLI paradigm). These are factors that both are connected to the location advantage of Georgia, as well as cases where the investors can contribute to the development of the country. An important aspect of the FDI is land acquisition, which will be discussed in this chapter. Before I do that, I will first give some background on the energy policy impacting the FDI in the hydropower sector.

4.1 Power policy

In Georgia the history of hydropower goes back to before the 1900. In the soviet period several hydropower plants were constructed, and most of them were connected to the neighbouring republic's power systems (menr.gov.ge 2011a). After the fall of the Soviet Union this system collapsed due to civil wars and a weak state structure, causing power deficiencies across the country. Like many of the country's hydropower plant the massive Enguri hydropower plant¹³, which is at the core of national energy production with an annual generation of 3.1 to 3.3 Twh, fell into a state of disrepair during the 1990s and sorely needed rehabilitation (dfwatch.net). There are also a number of medium-sized and small hydropower plants in Georgia, some only operating seasonally because the water flow drops significantly during the summer months (Econ 2010a, 10).

The year 2006 was interesting from an energy perspective. It began with the explosion of two gas pipelines from Russia, starkly illustrating the country's dependence on Russia and its energy vulnerability in general (Müller-Kraenner 2008, 23). The incident led the government to vow to diversify its energy supply (eurasianet.org). An independent energy expert interviewed for this thesis pointed out that Georgia was in a "bad energy situation" in 2006. Of all the post-soviet countries, Georgia paid the highest price for Russian oil and gas (Gochitashvili 2012, 21). Georgia has no oil and gas reserves of its own, but it does possess an abundant hydropower potential, and the government began to plan how to utilise this

¹³ The dam is located in Georgia, whereas the electricity station is situated in Abkhazian territory. Despite this, the Enguri hydropower plant has not been a source of conflict between Georgia and the secessionist republic.

domestic energy source. To reach this goal, a considerably higher level of investment in the energy sector was needed.

Later in 2006 the resolution on the “Main Direction of State Policy in the Power Sector” was declared. The main goal of the resolution was the satisfaction of the domestic energy demands of both the industrial and domestic sectors, based on full utilisation of the energy resources existing in the country and the diversification of imported energy (menr.gov.ge 2011b). The resolution devotes substantial attention to the utilisation of domestic hydropower resources. It stated that Georgia would increase the capacity of local energy resources and that “effective development of rich hydro resources of the country shall become the main direction for development of the power sector in Georgia” (menr.gov.ge 2011c). The Ministry of Energy and Natural Resources reacted quickly to the resolution, and within weeks the ministry had announced the opening for bidding on thirty-two small and medium-sized hydropower plants (GA 2006, 50). Among the twenty-one newly established hydropower projects was the Chorokhi River plant, for which the Ajar project won a concession in 2007 to develop the hydro potential of the Georgian side of the river.

The initial process in 2006 had limited success, but a new initiative accelerated the process; in 2008 the government declared the “Renewable Energy 2008” programme that included a list of potential greenfield projects and rules for the construction of renewable energy sources (menr.gov.ge 2011d). The two cases in this thesis are a result of the energy policy implemented since 2006, in combination with the state policy goal adopted in 2008. They are both part of the country’s strategy of attracting FDI to greenfield energy projects. The government wanted to make Georgia an attractive place for greenfield hydropower investment, and creating an attractive environment for FDI is related to the location (L) advantage in the OLI paradigm. Some of the restructuring and reforms introduced since 2006 are described below.

4.1.1 State restructuring

An obvious benefit of investing in Georgia is the abundant hydropower potential; there are about three hundred rivers that are possible sources for hydropower production, with an estimated annual potential capacity equivalent of 15000 MW (menr.gov.ge 2011e). However,

this is not enough as it must be financially viable as well as institutionally possible for investors to operate in the country. This section will look at some of the reforms the government introduced in order to attract FDI into the greenfield hydropower sector.

In the past, it has generally been the government's responsibility to develop, operate and own hydropower plants. However, this picture has changed since many states are finding it difficult to raise the funding needed for such projects, with the consequence that governments from all over the world have turned to the private sector for financing. With the increasing demand for investment in the power sector and a low-income budget, private investments can fill the gap (Inadomi 2010, 7). According to neoliberal thinking, private companies are more effective at completing and operating projects on time and within budget (*ibid.*, 7). This matches the picture of the development of the electricity sector in Georgia. After the Rose Revolution the electricity sector was transformed, with the industry being deregulated and separated into generation, transmission and distribution companies (menr.gov.ge 2011c). Processes such as optimisation and simplification have been given a high priority. Through simplification the goal has been to shrink the bureaucratic procedures to a minimum, making it easier for foreign investors to obtain concessions and licenses (Econ 2010a, 4). The numbers of licensing and permits have been reduced by 84%, which has made the process less bureaucratic and less time consuming for the investor (Gursoy 2008, 20). The application procedures are relatively easy and straightforward (see menr.gov.ge 2011d). The deregulation of the electricity sector has also reduced the likelihood of public corruption, which is one of the positive sides of neoliberal policy (Jomo and Fine 2006, 200). Corruption can harm economic growth as it discourages investment; specifically, paying bribes can increase the cost of doing business (Auty 2003, 12). Hydropower plant construction is long-term and costly, and therefore the political and institutional risks should be minimised (Hope and Skjeret 2008, 3).

Other developments in the electricity sector include the rehabilitation of existing hydropower plants, increased collection rates for distribution companies and a more stable electricity supply to most parts of the country (Econ 2010a, 4). The energy reforms noted above are in accordance with neoliberal ideas of deregulation, and are said to have followed the World Bank's 1998 Europe and Central Asia energy sector strategy (Lampietti 2004, 7).

It is the Ministry of Energy and Natural Resources that first and foremost regulates the sector. The ministry deals with energy policy, adopts strategies and puts forward recommendations, in addition to dealing with concessions and licensing to develop hydropower projects. Since 2006 it has been committed to a “radical reform agenda” (Econ 2010a, 4). On the ministry’s web page, it is stated that “the maximum utilization of the abundant hydro-electricity is one of the priorities of the state. The main objective of the long-run energy policy is the attraction of foreign investment for the construction of the new power plants (menr.gov.ge 2011c). Thus, the aims of the ministry seem quite clear: the more utilisation of hydroelectric power and the more FDI, the better. The increased hydropower production might also facilitate the achievement of another energy goal, namely the long-term strategy of replacing all thermal generation with cleaner and cheaper hydropower (UNFCCC 2012, 20). If Georgia wants to meet its goal of energy independence and replace thermal energy, it must increase its hydropower capacity (Econ 2010a, 12).

The head of the Investment Project Division at the Ministry of Energy and Natural Resources stated in the interview that the energy strategy since 2006 has been successful. He reported that the ministry had contracted over sixty hydropower projects. These figures include the construction of small, medium and large hydropower plants. About seventeen of the hydropower projects have already been launched, while others are under construction or in the planning stages (aarhus.ge). He also noted that the energy policy had been a quick success, which he believed was due to the government’s commitment to deal with the energy situation. More importantly, he said, the hydropower projects were very attractive for foreign investors because they were not exceedingly costly and there were no major environmental and social impacts compared with other such projects in the region. The independent energy expert agreed that the restructuring of the energy sector has been successful, despite some policy shortcomings, and that this should be recognised. The rehabilitation of existing hydropower plants, along with the construction of new production units and transnational oil and gas pipelines, has helped solve the country’s energy shortage (Gochitashvili 2012, 6). An advisor to the minister of energy and natural resources said that Western countries take twenty-four-hour electricity for granted in the twenty-first century, but for Georgians it was only a few years ago that the electricity supply was unstable all over the country. Power cuts still occur, but these are due to technical shortcomings and not the lack of supply of electricity. The

anonymous interviewee stated that the new energy policy would perhaps create new challenges, nevertheless, the surplus electricity “would bring hope to Georgia”.

Companies looking to invest in less developed countries like Georgia need incentives to do so. With worldwide competition to attract FDI it is understandable that the Georgian government would want to minimise the risk for foreign investors by creating a favourable investment climate (Gursoy 2008, 21). When it comes to attracting potential foreign investors the country must strike a balance between investor-friendly and revenue beneficial policies. Also, the electricity policy should consider consumer demand, as electricity is difficult to store (Hope and Skjeret 2008, 3).

4.1.2 Energy demand

With a population of 4.5 million, Georgia has a relatively small domestic market (Gursoy 2008, 20). According to a study from the consulting agency Econ, which was commissioned by the government of Georgia, the country needs more hydropower to meet its own demand and decrease imports in high demand seasons (Econ 2010a). However, during low demand seasons the country has a large surplus of electricity. In 2006 hydro generation constituted about 64% of the total electricity supply, while thermal generation and imports accounted for 27% and 9%, respectively (UNFCCC 2012, 7). However, by 2010 hydropower constituted 88% of the total power generation (Econ 2010a, 10). Domestic utilisation has therefore increased significantly in only a few years. In addition, since 2007 Georgia has been a net exporter of electricity to other countries in the region.

The energy consumption amongst the population is low; Norway consumes six times more energy per capita (GA 2011, 63). Despite an increasing demand in Georgia since 2006, energy saving measures might offset the increase. A soviet heritage involved the tendency to be very energy-inefficient, a legacy which Georgia struggled with throughout the 1990s, but this is slowly changing (Econ 2010a, 7). According to the acting director at the Energy Efficiency Centre, the introduction of energy saving measures and the rehabilitation of existing hydropower plants means that Georgia might be able to meet the domestic electricity demands. Several reports from NGOs support this analysis, arguing that greenfield hydropower plants are unnecessary for Georgia (e.g. GA 2007).

With the domestic demand already satisfied most of the year, where will all the electricity from the new hydropower plants go? Market size and projected growth rates are considered to be location advantages in the OLI paradigm (Neuhaus 2006, 143). The Georgian electricity market is not particularly attractive from an investor's point of view, with low tariffs and mainly saturated electricity demand. However, when one adds the market potential of neighbouring Turkey, the picture changes substantially. Turkey has a large and increasing population, the economic indicators are on the up, the demand for electricity is rising, and the tariffs are higher than in Georgia (Yüksek 2008, 3381). With Turkey in the equation the number of potential buyers and expected profits are hugely increased, since the distance to this highly attractive market is short (Neuhaus 2006, 143).

To promote electricity exports, the government decided to increase cross-border capacity by building transmissions lines for electricity going to Turkey. This will decrease transport costs for investors as well as increase the export capacity (menr.gov.ge 2011e). As Neuhaus (2006, 144) points out, long-term FDI decisions, such as the construction of hydropower plants, are not based merely on the present state but also on predictions of future market demand. The prognoses for the electricity market in Turkey have been promising for years (Demirbaş 2002b, 1884). Both of the hydropower cases studied in this thesis are planning to export a large quantity of the electricity produced to Turkey (MacDonald 2012, 54). There are profits to be made by exporting electricity to Turkey, as forecasts show that the Turkish market is lucrative and is likely to remain so for years to come (investingeorgia.org). Accordingly, selling the excess power to the Turkish market is vital.

The consulting agency Econ suggested in a report that there are two potential options for Georgia's surplus electricity. Option one is to export to other markets, such as to neighbouring Turkey or Azerbaijan (Econ 2010a, 19). A calculation from the same company forecasts an annual income of between 32 and 200 million USD (*ibid.*, 19). Option two is to promote the country as an attractive place for energy-intensive industry, such as cement and aluminium production, with the incentive being the low electricity cost over the lifespan of an industrial plant (Econ 2010a, 19–20). The latter option can hardly compete with the first one when it comes to the amount of hard currency inflow. With the significant fluctuation between the seasons, there is likely to be a large surplus of energy during the summer months. Hydropower investments are typically expensive, irreversible and long-lived, and one of the

particular issues with electricity is that it is difficult to store (Hope and Skjeret 2008, 3). Therefore, the export of electricity is a viable option for greenfield hydropower plants because Georgia is likely to have a large surplus during the summer months.

Georgia has ambitions to export electricity to Eastern Europe, but is dependent on Turkey as a transit country (investinbatumi.ge 2011). As part of the energy strategy the government decided to invest in new transmission capacity to Turkey (menr.gov.ge 2011e). A senior adviser to the minister of energy and natural resources stated that when it comes to hydropower development Georgia is “landlocked” without Turkey. She also noted that Georgia has tried to conform to EU standards, but these efforts might prove to be in vain if Turkey does not also implement the same standards. The EU’s impact on Georgia’s energy policy is interesting, but it lies beyond the scope of this thesis.

Georgia had little industry left after the fall of the Soviet Union. One might ask if the two strategies could be combined, since the development of heavy industry could both provide revenues and create long-term employment. Some evidence suggests that in the long run the manufacture of goods can be more profitable than exporting the raw materials, although this in part depends on the type of manufacturing (Milford 2013). In the end the government chose option one, and has focused on developing hydropower plants with exports to Turkey and perhaps to other markets in the future. In the short term the government needed finances to build the hydropower plants, and accordingly reforms were rapidly implemented to make Georgia an attractive hydropower investment site.

The location advantages mentioned above require that the company can utilise the local potential in order to make a profitable investment, e.g. closeness to the market (Neuhaus 2006, 145). An apparent advantage for the Ajar project is its physical proximity to Turkey, and that country’s historical and economic connection with Ajara (Pelkmans 2006, 7, 183). The plants are only a few miles from Turkey, and through its mother company the Ajar project first-hand connections to and knowledge about the hydropower sector in Turkey. While the Norwegian AGL does not have the advantage of proximity, it nevertheless has other ownership advantages related to knowledge of the market. One individual on the management team had previously worked in the consulting agency Econ Poyry, which advised Georgia on the energy sector (see e.g. Econ 2010a), and was an advisor to the

Georgian government on the country's hydropower development, before joining CEG in 2010 (cleanenergygroup.no 2011c). In addition, the management team included the former chief executive officer of the Norwegian company Statkraft, Europe's largest renewable energy company, who oversaw the company's investments in leading emerging hydro markets such as India, Peru and Turkey (statkraft.no). Hence, the AGL project also has managerial expertise that will facilitate the operation in Georgia. Both companies are utilising their management ownership advantage by investing in the sector.

4.1.3 The protests

As with most comprehensive reforms, there are opponents to the schemes. For the investor it is a drawback if the project should attract national and local protests. This section will outline some of the general protest against the greenfield hydropower plants. The affected population and several NGOs in Georgia are worried that the construction of the greenfield hydropower projects will trigger environmental disasters or cause severe environmental harm (iwpr.net). In addition, there are fears about forced resettlement and lack of compensation during the land acquisition process (GA 2007, 12). The energy policy since 2006 has been criticised by NGOs, and several of the interviewees stated that a major drawback of the policy is its avoidance of concreteness.

The co-chair of the Greens Movement, one of the country's largest and oldest environmental NGOs, stated that while the energy policy expresses high ambitions for increasing hydropower capacity, there is no clearly articulated policy concerning what the government plans to do with all the surplus electricity. In addition, she noted that all social and environmental issues must be settled before any kind of work can begin. The co-chair also said that the NGO's main objection to the new greenfield hydropower plants was that it is difficult to see any major benefit for Georgia; the country might get new hydropower plants, but that is about it.

These views were echoed in interviews with a representative from another large environmental protection NGO, Green Alternative, which is perhaps the NGO that most strongly opposes the current hydropower development (greenalt.org 2012a). Since 2006 Green Alternative has devoted attention to hydropower development because it has been

concerned about the potential social and environmental damage of all the greenfield hydropower projects. The interviewee at Green Alternative said there were too many projects too soon, and that the government was thinking in a very business-like manner by undertaking all the projects. Although he was not sure exactly how many developments were currently contracted, he emphasised that the projects were numerous, and for that reason Green Alternative had decided to allocate its resources mainly against the larger projects. One of its main campaigns in 2012 was called “No to big dams!” (greenalt.org 2012a). However, the interviewee at Green Alternative also said that the NGO is not actually against large hydropower in general; rather, it seeks a strategy for how the development can be optimised for Georgia’s sake. He was sceptical about the energy policy since 2006, saying that there is no strategic plan for how Georgia might benefit, and consequently there is a significant risk that the country will lose more than it will gain.

The project coordinator at the Aarhus Centre also noted the lack of a concrete energy strategy. She believed that the government’s plan was one-sided, since a large demand for hydropower was declared after 2006 but without much attention to the wider picture. The project coordinator said that openness and transparency are important, and with a clear strategy it would be easier for experts to comment on the development and to contribute with nuanced criticisms and suggestions. A lawyer at Transparency Georgia also thought that the energy policy was unspecific, and that Georgia relied on concepts but had no clear plan.

The two interviewees at the Ministry of Energy and Natural Resources also agreed that the 2006 policy was concept-oriented. The head of the Investment Projects Division at the ministry said that although the energy resolution of 2006 spoke in general terms, he believed it was suitably formulated because it clearly stated what the framework of the energy sector development ought to be. He believed that it accurately described the situation of the hydropower sector, pointing out the need for rehabilitation as well as the need to increase the electricity capacity. He further noted that Georgia has abundant rivers, but little oil or gas¹⁴, and the country had to utilise its own domestic potential so that it might achieve energy independence.

¹⁴ Georgia has some smaller reserves in Samgori.

The activists at Green Alternative does not agree with this assessment. According to him, electricity accounts for just 25% of the total energy consumption. Thus, he believes that the government is wrong when it claims that Georgia will achieve energy independence through the construction of new plants and rehabilitation of existing ones. Even if all the planned hydropower projects are constructed, electricity still accounts for only a quarter of the energy balance. The NGO is sceptical of the major investment in greenfield hydropower, since it does not solve all the energy problems of Georgia, but it does increase the risk of social and environmental challenges.

In addition, the two local environmental NGOs were concerned that many of the decisions made within the hydropower reform have no clear rational from the government. One of these is the ten years–rule, by which the hydropower producers will have to sell electricity to the domestic Georgian market during the high demand winter months (December to February) for ten years (menr.gov.ge 2011c). Green Alternative asks “why ten years why not five or twenty?” Not one of the interviewees knew why the period of ten years had been chosen, not even the two interviewees at the Ministry of Energy and Natural Resources. One of the civil servants thought it would be a reasonable time for both the investor and the country, which would have better energy conditions in ten year’s time. Reasonable or not, an official justification could not be found.

Nonetheless, it makes sense to secure electricity for the domestic market because the tariffs are higher in Turkey during the high demand season (Yüksek 2008, 3376). Without this strategy, Georgia could be left with a shortage of domestic electricity, despite producing more than enough. In addition, it is not a great inconvenience for the investor who is still guaranteed sales for those months (investinbatumi.ge 2011). This is one of the few known preconditions for FDI in hydropower greenfield constructions, whereby the Georgians are securing a quantity of supply for some years. In ten years’ time the energy situation may have changed and such a policy may be unnecessary, yet it is one of several decisions where the motive is not publicly known.

4.2 Tariffs

Another concern for the NGOs was the potential increases in electricity tariffs for the Georgian population. The electricity tariffs of the greenfield hydropower plants must balance between being affordable to the population, and bringing in enough revenue for the investor to make a profit. Neither of the two companies would offer a special electricity price for the affected population, and no other hydropower project in Georgia has offered to do so either. In public meetings about the two cases the question of tariffs came up frequently, since the local population was concerned that the electricity prices may increase (UNFCCC 2006, 39). As will be discussed below, this might be a reason for concern.

Electricity prices have been low in Georgia, and prior to 2008 the low price level and weak payment collection meant that the electricity market was not seen as commercially profitable (Econ 2010b, 23). Though the tariffs have increased considerably over the last fifteen years, Georgia still has the region's cheapest energy supplies (*ibid*). The distribution tariffs are considered to be low at about 8 USD cent/Kwh excluding VAT, which is well below the Western European average (Econ 2010a, 3). In the past, the tariffs during the summer months have been very low, due to a large surplus of electricity combined with limited export capacity (Econ 2010b, 23). The situation has changed with increasing prices and new transmission lines for electricity export. A forecast of a profitable tariff is an important consideration for potential investors in greenfield hydropower plants.

As for Georgia's neoliberal policy path, the liberalisation of the energy market and the encouragement of export are not likely to decrease the price of electricity. On the contrary, such measures tend to increase the tariffs (Hope and Skjeret 2008, 3). In addition, the surplus electricity will not help reduce the price for Georgian consumers, as the surplus will be exported to Turkey (tol.org). Turkey has been actively promoted as an important consumer of Georgia's excess electricity (investinbatumi.ge 2011). The government has constructed 500 and 153 KV power transmission lines to Turkey to increase the export capacity (menr.gov.ge 2011c). The government is probably aware of the risk that domestic tariffs will increase due to the construction of new transmission lines, but for obvious reasons it does not want to highlight this aspect of the development.

The National Electricity and Water Regulatory Commission (GNERC) is responsible for regulating the power sector (gnerc.com). Among other tasks, it sets the transmission tariffs (Econ 2010a, 29). GNERC is an independent agency, but the Greens Movement and Green Alternative NGOs have questioned its status. The anonymous interviewee suggested that GNERC might be subject to political pressure, and could, for example, be pressured not to adjust tariffs according to inflation. This could lead to the erosion of investors' income (Econ 2010a, 23).

The tariffs for greenfield hydropower plants are fully deregulated. With no tariffs set for these plants, foreign investors are free to negotiate the price and the market (Econ 2010b, 13). According to records from public meetings between the investors and the affected people, the investors avoid the question of tariffs by claiming that such matters will be settled by GNERC, and the private companies cannot decide on this issue (UNFCCC 2012, 60, UNFCCC 2006, 39). However, while it is indeed GNERC who sets the rate, the system allows the producers to agree on certain tariffs to reduce the risk for investors. With the investors in the greenfield hydropower plants negotiating with GNERC, companies might be able to ensure acceptable returns before committing to a project (Econ 2010a, 14). For the investors, Clean Development Mechanism (CDM) credits may make the hydropower projects more profitable (*ibid.*, 14). In November 2012 the AGL project registered with UNFCCC as a CDM project. Accordingly, the project is the first greenfield hydropower project to obtain registration with UNFCCC in Georgia (adjaristsqali.com 2013a).

It is clear that increasing tariffs will never be politically popular. The government hopes to prevent increasing prices by phasing out thermal power production. Thermal generation is more expensive and less environmentally friendly than domestically generated hydropower (Econ 2010a, 16). The interviewee from the Ministry of Energy and Natural Resources mentioned that the government had built a new high voltage line to Turkey at "our own expense". This means that government revenue has been spent to construct more transmission capacity. These investments are costly for the Georgian national budget, but good infrastructure might be an important precondition for making Georgia a lucrative investment location. Clearly the new transmission line is good news for investors looking to export electricity to the Turkish market, and it increases the location advantage of being close to that attractive market. With higher tariffs, there is more profit to be made by selling to the Turkish

market than by selling the electricity in Georgia. In addition, the Turkish market is far larger and is increasing faster due to long-term economic growth (Demirbaş 2002a, 27). Yet another advantage for investors is that the greenfield hydropower plants have priority access for transmission to Turkey (investinbatumi.ge 2011).

How the developments will benefit the Georgian population remains more uncertain. Unlike some of its post-soviet neighbours, Georgia does not subsidise the population's energy consumption (Lampietti 2004, 27). The curtailing of governmental subsidies can be seen as a consequence of the Washington Consensus (Jomo and Fine 2006, 26). Though the electricity price as of 2013 is still relatively cheap, it should be noted that many Georgian households rely on fuel wood for heating and cooking, with this source of energy forming a large part of their consumption (Lampietti 2004, 9). If the development of greenfield hydropower plants increases the price of electricity, it may lead to the poorer sections of the Georgian population increasing their use of "dirty fuels" such as wood and kerosene (*ibid.*, 9). This would be an unfortunate environmental consequence, and it remains to be seen whether tariffs will be influenced by commercial or political considerations.

4.3 Taxation

Tax revenues are crucial for funding public infrastructure and services. On the one hand, foreign investors obviously prefer to be taxed as little as possible, but they are willing to pay as long as the investment prognoses look profitable. On the other hand, the government tries to promote greenfield hydropower projects as an important part of the country's economic development, but civil society remains sceptical. It has been questioned whether the greenfield hydropower construction boom will bring sizeable economic gains for Georgia (tol.org). A direct way of benefiting is through taxation, which this section will examine in more detail.

The neoliberal ideal is that the tax base should be broadened and tax rates cut (Jomo and Fine 2006, 26). Georgia has followed this model, and has altered the tax code several times over the last few years. Though the tax code has been simplified, an IFC survey from 2006 showed that few business owners understood the tax legislation. This is perhaps unsurprising as the legislation was amended seventeen times between January 2005 and November 2006 (Jones

2013, 121). Expatriates living in Georgia suggested that although the tax regime was simplified, there was still some uncertainty about which taxes foreign businesses had to pay.

At the state agency “Invest in Batumi” the officers said that the government is striving to move towards the best international practices in taxation. Thus, the country has undergone several procedures of simplification that have targeted both the population and the business sector. The amendments to the tax code were inspired by the IMF and the World Bank (Davis and Kruse 2007, 1096). The reforms have been a notable success, since it is believed that the simplified tax regulations have improved tax collection since 2005 (Transparency 2011c, 1).

According to the EDBI, Georgia ranks in thirty-third place globally when it comes to tax reform (WB 2013, 66). Tax improvements include simplified export and import procedures, for instance, in 2005 the corporate profit tax was reduced from 20% to 15% (Transparency 2011c, 2). The improvements are aimed at making Georgia an attractive business location globally, and it has achieved some international recognition; for example in 2008 Forbes Magazine¹⁵ labelled Georgia as the “4th Least Tax-Burdened Country” (nbiexpo.com). However, the location advantage of having liberal tax regulations might not yield much revenue to Georgia in the short term. According to the interviewee at Green Alternative, the Georgian tax system allows tax depreciation. He stated that it might be difficult to obtain income taxes from the greenfield hydropower projects because the investors can report high spending for years and use this as a way to avoid reporting positive net income in their financial statements. Thus, he concluded that Georgia is losing a lot more than it is gaining from the hydropower developments.

The cost of export is an essential issue for foreign investors in the hydropower sector, since the greenfield hydroelectric projects are export-oriented. In Georgia there are no customs tariffs on export and re-export (Batumi Invest 2012). In addition, it is worth mentioning that Georgia has a free trade agreement with Turkey, facilitating trade between the two countries (*ibid.*). This seems to be inspired by neoliberal theory, where tariffs are to be replaced by quotas and reduced as quickly as possible. This is in connection with the “liberalisation of FDI”, where FDI was to be encouraged by removing the barriers that prevent foreign companies from investing in the domestic market (Jomo and Fine 2006, 26). These reforms

¹⁵ An American business magazine, perhaps best known for its list of billionaires.

make the country more attractive for potential investors as they increase the location advantage in the OLI paradigm.

The head of the Investment Projects Division at the Ministry of Energy and Natural Resources noted that after the hydropower plants have been in operation for perhaps ten to fifteen years, it might be an idea to reconsider the current tax regime and consider the introduction of additional taxation. For the moment, however, it is more important to have incentives for potential investors, particularly little or no taxation. Georgia did not have the best bargaining position at the outset of 2006, but the position might change in the coming years.

Another tax that should be mentioned is property tax, but the two local environmental NGOs do not believe that this will generate much tax revenue either. Georgian property tax is low, ranging from zero to 1% (investinbatumi.ge 2011). While 1% is not much, it is still a stable source of revenue, especially from a long-term perspective. Some of the land plots that will be acquired by the two cases are state-owned, and by buying up the land the companies will create a new and stable source of state revenue. The AGL project envisages paying a municipal tax of approximately 1% of the project's property value per year; the exact figure is currently unknown, but is believed to be in the range of 1 to 3 million USD. The tax revenue will be allocated to the local municipality where the power plants are located (MacDonald 2012, 55). No such estimate was available from the Ajar project. This demonstrates that there will be a significant increase in tax revenue in the local municipalities.

Hydropower is a long-term investment, and the financial results must be considered over the lifespan of the hydropower plants, which is not known yet. In the short term there may be a limited increase in revenues because tax rates are low, as is the case with property tax. However, even a small increase in revenue is better than none, although increased budget revenues are likely to be modest in the short term (tol.org). The conclusion must be that it is difficult to estimate whether the greenfield projects will make a substantial contribution financially. However, a more pressing matter is the question of land acquisition for the hydropower projects.

4.4 Land issues

This section will demonstrate that the issue of private property and land acquisition poses an important challenge in post-soviet Georgia. There was a consensus among the interviewed stakeholders that there are several challenges connected to the execution of property rights, both for Georgia in general and directly related to the hydropower cases.

Private property rights are at the core of a market economy. Privatisation in a broad sense includes creating and reforming property rights and the redistribution of control over the means of production (Hibou 2004, 183). For all post-soviet countries, going from a system without private ownership to one where actors engage as sellers and buyers was an enormous challenge. Privatisation was viewed as an irreversible and unavoidable reform process that would ensure the transition to a market economy (Åslund 2007, 33). With the privatisation process, Georgians were able to register and become private landowners as in any other capitalist country. Neoliberalism promotes privatisation as a means to reduce state interference (Jomo and Fine 2006, 150). Initially, privatisation was not a success for the former Soviet Union, while the Eastern European countries were more successful in the implementation of privatisation reforms (Åslund 2007, 169), indicating that the length of time under soviet influence makes a difference (Stiglitz 1999, 1). Jomo and Fine (2006, 157) argue that the privatisation process is shaped by the historical, economic and social context in which it is implemented. Hence, they argue that policies should be chosen based on the condition of the country's needs rather than on neoliberal ideology (*ibid.*, 159). Thus, one could argue that the privatisation process in Georgia has been shaped by past and current challenges.

Initially in the 1990s the Georgian privatisation process had a slow start, which might have encouraged the post-Rose Revolution government to pursue privatisation as a means of increasing efficiency and revenue. Under President Saakashvili the privatisation process accelerated, bringing budgetary benefits; in 2007 15% of the budget was accounted for by the sales of state property (Jones 2013, 200). However, the selling of assets only yielded profits in the short term, and additionally the process was opaque and led to public distrust (*ibid.*). The constitution, the law and international norms and regulations guarantee property protection. However, as there have been several cases of property right infringements since the Rose Revolution, the population may have reason to remain sceptical (Transparency 2012, 5).

Reforms since 2003 have resulted in limited improvements, and property rights are still not secure (Jones 2013, 200). Infringement of property rights is particularly likely to happen in Georgia's fastest growing sectors, namely the tourist and construction industries (Transparency 2012, 4, 12). Hence, it is not surprising that stakeholders emphasised property rights as one of the main challenges related to greenfield hydropower development.

4.4.1 Registering property

The two hydropower companies have both struggled with the land acquisition process, as will be discussed below. The NGOs were particularly critical of the status of property protection on behalf of the Georgian population. The weaknesses of property protection include a weak legislative apparatus and the lack of a national resettlement policy (Transparency 2011a, 5). The government representatives, the NGOs and the two companies all express in the interviews that it is a challenge that many Georgians living in the affected areas of the greenfield hydropower projects have not registered their property. This was creating inconvenience for all parties involved.

According to the activist at Green Alternative, there are several reasons why Georgians have not registered their property. Partly this is a result of the soviet heritage, where the population lived on state-owned land for decades. After independence those Georgians that registered their land tended to live in urban areas, but for rural citizens it was not an urgent matter. A lawyer at Transparency Georgia noted that the rural population tends to live far from registration offices, making it harder for them to obtain their property rights. To a large extent Ajara has been moving out of its backwater status after the republic's "return to Georgia" in 2004, and major developments along the Black Sea coast have occurred since then. However, the inland areas where the two hydropower projects are located have been largely left out of this development. It is estimated that many living in the more remote mountainous regions of Ajara, such as the affected AGL areas, have never registered their land (Transparency 2011a, 10).

An aspect of the post-soviet reality is the frequent amendments of the Georgian legal code. Laws regarding property rights have been altered several times since independence, and not all Georgians have the right registration papers. This cause difficulty when foreign companies

try to acquire land. Another challenge, according to the project coordinator at Caucasus Environmental NGO Network, was that the Georgian legal framework has no laws on so-called traditional ownership, referring to lands that a family has been cultivating for years but has had difficulties registering (transparency.ge 2012). In the mountainous areas, the population often do not have the official papers even though their land has been in the family for generations. Under current law, people living unregistered on state-owned land have no right to compensation when hydropower projects acquire the land. Thus, the question of potential compensation in such cases is a moral issue for foreign companies rather than a question of legal rights, as stated by the lawyer at Transparency Georgia. A report for Transparency Georgia notes that the “cases of real property infringement are reported mainly in areas where investments or infrastructure projects are planned” (Transparency 2012, 12). Accordingly, the greenfield hydropower plants may be at risk of breaching property rights and traditional land tenure processes.

There have been several examples of property rights infringements in post-Rose Revolution Georgia (Transparency 2012, 4). In Ajara, Transparency International’s Batumi Office reported that this had happened in the republic as well. Between 2007 and 2010 in the village of Gonio, a proposed tourist destination located along the Black Sea coast, 271 villagers were deprived of their property without any form of compensation. Gonio is not an isolated case; this kind of property acquisition is part of the socio-economic and political processes in Georgia (Transparency 2011b, 2). However, the interviewee at Transparency Batumi did not believe that such a scenario would occur with the hydropower projects in Ajara. Although there had been disagreements, it looked like those who were entitled to compensation would receive it. She believed that conflicts might still arise, such as the affected population demanding more compensation than the companies would be willing to offer. Next we will look at land acquisition and discuss the different outcome of these issues in relation to the two cases.

4.4.2 Land acquisition

There are two forms of resettlement that come about due to project-related land acquisition. One is physical displacement, which includes relocation or loss of residence. The second is economic displacement, referring to the loss of assets or livelihood. Neither project envisages

the former, but the latter is a large part of both projects (UNFCCC 2012, 58). According to ESIA studies, no physical resettlement will be necessary for either of the projects, as no homes will be flooded when creating the reservoirs (Gamma 2011, 220–222). As there is no resettlement, no historical monuments to be flooded and no significant negative environmental consequences anticipated, the projects are not among the most controversial in Georgia. Still, the construction of the hydro schemes require land, e.g. for reservoirs and access roads. Some of the land is private and some is state-owned, and in several cases the local population live unregistered on state-owned land (UNFCCC 2006, 40).

The ESIA report for the Ajar project states that no buildings will be flooded, but it goes on to suggest that some people's living conditions will "be dramatically worsened" (Gamma 2011, 221). The Ajar project divides landowners into two categories: registered landowners and unregistered landowners. Both are entitled to compensation, but the latter are entitled only after their ownership is registered. Transparency Batumi will help unregistered owners to register, thereby making the local population eligible for compensation. The company does not envisage paying those who use land without rights, and they are not obliged to do so by Georgian law. The lawyer at Transparency's Batumi office said that the Ajar project had expended a good deal of effort mapping land plots, and had encouraged the local population to register their land. The land plots needed for the Ajar project are valued higher than those of the AGL project, and consequently the price per square metre is higher at between 8 to 10 GEL, approximately 4.8 to 6 USD.

Yet attempts at ownership registration are sometimes challenging. In the summer of 2012, sixty locals in the Ajar-affected areas faced difficulties registering private property in the civil registry. The main problem was that the local commission had ceased to function during the period they wanted to register (transparency.ge 2012), illustrating how difficult it can be for the local population to obtain their property rights. The lawyer at International Batumi's office said the organisation followed the hydropower project, and had worked to provide information about and be part of the negotiations between the company and the population (transparency.ge 2012).

As mentioned above, the frequent reforms are a challenge for the land registration, which can be seen in the case of the Ajar project. In the election year of 2008¹⁶ the government launched an advertising campaign under the slogan “What is yours is yours”. The aim was to simplify the process of registering private persons as landowners. However, after the elections were over, new amendments made it harder to register and the registration fee was also increased (Transparency 2011b, 3). A similar incident occurred immediately before the parliamentary election in 2012. The local government issued documents to the locals so that they could register land. This was particularly important for the Ajar project, since the company would compensate only those who had registered their property. However, the authorities may have been too generous since land certificates were easily issued, including land plots that are not usually in public possession, such as parts of river beds. In early 2013 the Ajar project went to court in a dispute with several landowners because the company claimed that registrations were made incorrectly during the pre-election period and therefore they should be annulled (beyondtbilisi.ge 2013).

The new government does not appear to back the decisions made in the pre-election period, which makes the legal status of land registrations granted in this period uncertain. By March 2013 Transparency Batumi had represented about ten people in court against the company, in cases where the parties agreed to negotiate. Even though the construction phase of the project has lasted nearly a year, the land acquisition issues are still not completely settled. The PR manager at the project said that the problems were a result of the frequent ministerial changes; it is one of the features of post-soviet Georgia that government officials are often replaced (Jervalidze 2007, 3). Interestingly, in this instance the authorities put the interests of the population before the investor. The PR manager at the Ajar project said it had been hard to work with frequent ministerial changes, as each new minister introduces new policies. After the parliamentary election in October 2012 a new minister of energy and natural resources was appointed, a thirty-five-year-old former AC Milan player who entered politics in early 2012 (menr.gov.ge 2012b).

Regarding the AGL project and land acquisition, the informant at the project stated that one of the best aspects of the project was that there was no physical resettlement and no one had to leave their homes. Some will lose land plots, she said, but the company will compensate them

¹⁶ In 2008 were “snap” presidential and parliamentary elections.

fairly and equally. A couple of buildings will be flooded, including a petrol station which the company will move further up the valley. In addition, the reservoir will also flood parts of the main road in the area; this will also be moved (MacDonald 2012). According to the informant at AGL, the project spent a great deal of time gathering information for the land acquisition. Eventually the company decided to go for a design where all land users, regardless of legal status, would get compensation. The AGL project divides landowners into three divisions: (registered) landowners, (unregistered) land users, and “illegally seized” plots (UNFCCC 2006, 55). For unregistered land users, the company will help them and pay for registration in the Public Register. Those in the “illegally seized” plots category will also be compensated, according to the informant at the AGL project. In effect, for these landowners the company will pay double because these plots are state-registered (*ibid.*, 55). The informant at AGL said that as a goodwill gesture the company does not differentiate between landowners and land users. The AGL project’s policy on land acquisition is in accordance with World Bank/IFC standards, or so-called “international best practice” standards. As the IFC is a (financial) co-developer of the project, the financial institution’s policy has had an impact on the project’s policy choice. The institution’s policy is considered to be of a higher standard than the Georgian legal framework (GA 2006, 5). Clearly, paying for the land twice is more costly, but the advantage is that this strategy may prevent discontent in the local population and decrease the risk of becoming involved in court battles that could last for years.

The price for land acquisition is subject to land assignment, according to which the company had two different evaluations. As mentioned by the AGL informant, the National Forensic Bureau priced a metre-squared plot of land at 3 to 5.5 GEL (1.8 to 3.3 USD) on average, as the state agency tends to put a low value on the land (GA 2006, 25). However, the private company Expert-21 assessed the same land and returned an average price of 6 to 8 GEL (3.6 to 4.9 USD) estimated according to the market price, of which the AGL project plans to increase the compensation payments by about 10%. Consequently, for the AGL project the price varies from 6 to 10 GEL (3.6 to 6.1 USD) (UNFCCC 2006, 57). Additionally, the company will also compensate landowners for any fruit trees lost. The informant at the AGL project said that this had been a surprisingly complicated issue, and at the time of the interview it was not yet clear how the problem of fruit tree compensation should be solved.

4.4.3 Property rights

In contrast to what the stakeholders have been told, the EDBI rates Georgia in first place out of 185 countries on the ease of registering property (WB 2013, 42). Although being number one in this ranking is an impressive achievement, it does not reflect the realities of property issues. Papava (2009, 203) argues that the government does not protect private ownership, and the World Bank's high rating for Georgia is unrealistic. The ranking implies that the issue of property is settled, despite the fact that several challenges remain. It is indeed easy to get land registered, but this does not reflect the real state of property rights in the country. It is true that it is easy to register land plots online (see napr.gov.ge), but this is not the case for the populations of mountainous regions who seldom have computers, let alone access to the internet at home. One may therefore question whether these registration tools are there to help the people living in the mountainous areas, or merely to meet the standards set by the World Bank. The implemented measures seem to have done little to improve the situation for the Georgian population. This reform would perhaps be better suited to other countries ranking in the top ten in the index, such as Norway or Singapore (doingbusiness.org 2013a). At least in these countries most citizens have access to the internet and hence have easier access to the execution of their property rights. Georgia presents itself in international advertisements as if the legal framework surrounding property conforms to a world standard. Georgia has promoted itself as a serious reformer, which is true to an extent, but it still has a long way to go before the country will have achieved the adequate execution of property rights for both the population and the investors.

Land acquisition by foreign companies is a controversial issue all over the world. Thus, it is not unexpected that some of the population will complain about compensation, nor is it unusual that companies feel pressured to compensate for more than the land plot is worth. This is not specific to Georgia as a post-soviet country since cases may also be found elsewhere. The main point is that there is a lack of adequate reform measures, which should include a more accessible registration procedure for the Georgian population, and there is a need for a new resettlement act for those who may have to move due to construction. The government should focus on the best and most suitable policy for the situation in Georgia, rather than the best policy according to an external organisation. The reforms introduced are

not harmful for Georgia, but neither are they aimed at helping the population; rather, they are intended to facilitate a top EDBI ranking.

The current situation is not optimal for foreign companies who may not have a clear idea of the risks and challenges of the Georgian property market. Political risks should be minimised, because hydropower projects are costly and the government should aim to attract good investors. For the government, the current situation might allow flexibility, but it may also be harmful to private companies and the population.

4.5 Conclusion

This chapter demonstrated that the government has used reforms to create a more lucrative environment for greenfield FDI. The electricity sector is deregulated and the bureaucratic procedures for greenfield investment are substantially reduced. The successes of this strategy should be recognised, and they explain why the government has managed to attract several investors to the sector in a short handful of years. Georgia has become an attractive location for greenfield hydropower investment. Several stakeholders agreed that the energy policy was unspecific, but some thought that this was more problematic than others. The NGOs were critical not so much of the hydropower itself but of the business-like approach of the government, and they were worried that social and environmental aspects were not being considered.

It was noted that there are no taxes on energy exports, and consequently the export of electricity will generate little revenue. Tariffs are likely to increase due to the hydropower developments. Despite a liberal tax regime with a relatively low tax rate, taxation revenues will likely increase due to the greenfield investments. This section has also shown that the property situation in Georgia is not stable, for instance, with the Ajar project even well into the construction phase of the questions of land registration and land acquisition have not been solved, and this is serious for all the stakeholders involved.

5 Environmental and social issues

In this chapter, I will look at the environmental and social impacts of the hydropower plants. The combination of environmental and social issues is inspired by the fact that most Georgian environmental NGOs are both environmentally and socially concerned. Indeed, Green Alternative and the Greens Movement, the local environmental NGOs interviewed for this thesis, do not focus solely on environmental issues but also have a strong social agenda. Green Alternative's profile has an apparently stronger social perspective than environmental, especially when it comes to hydropower. The interviewee at Green Alternative said that they were activists rather than researchers in the natural sciences. In contrast, the Greens Movement has a more diverse staff ranging from politicians and lawyers to fish experts. Though this NGO has the expertise to evaluate environmental issues, it also places emphasis on social issues in response to the social and economic situation in Georgia. As mentioned in Chapter Four, the local NGOs are sceptical that Georgia will benefit from the greenfield hydropower plants.

The minister of energy and natural resources from 2007 to 2012, Alexander Khetaguri, has stated several times that the greenfield hydropower plants will improve the social and economic situation in the affected areas (georgianamerica.com). This chapter will also discuss whether the FDI inflow can have positive social and economic effect for Georgia. I will look at if the hydropower development will be beneficial in terms of job creation, and the public relationship between the foreign company and the affected population will be analysed.

5.1 The Ministries: power struggle?

Jones claims that neither the government nor the population prioritises the environment (2013, 261). This is perhaps too broad of a statement, although even the civil servant at the Ministry of Environment Protection admitted that the environment had not been a "top priority". As the civil servant pointed out, the population will consider food and work before thinking about environmental issues.

According to the two hydropower companies, AGL and Ajar, they have mainly dealt with the Ministry of Energy and Natural Resources. The ministry issues the concessions, permits and

licenses needed for the hydropower projects, as a consequence of the restructuring process among the ministries after the Rose Revolution. The reorganisation of another ministry, the Ministry of Environment Protection, was brought up in several of the interviews to illustrate the government's priorities since 2006.

The Ministry of Environment Protection and Natural Resources of Georgia was established in 1991. The ministry was later renamed the Ministry of Environment Protection, when the management of natural resources was transferred to another ministry (moe.gov.ge). Within a few years the licensing for exploitation of natural resources went from the Ministry of Environment Protection to the Ministry of Economy, before ending up within the remit of the Ministry of Energy¹⁷ (civil.ge 2013). The environmental NGOs interpreted the transfer as the government wishing to separate issues of the environment and sustainable development. It might also indicate that the government views natural resources as something that ought to be exploited, not protected (Jones 2013, 263).

It was difficult to find an official rationale for the restructuring of the ministries. According to a civil servant at the Ministry of Energy and Natural Resources, the logic was that the ministry would be in correspondence with neighbouring countries, and thus could “talk completely on all issues when meeting at ministry level”. While this is true for trade partners such as Turkey, Armenia and Kazakhstan, it is not the case for other countries, for instance Azerbaijan, Bulgaria, Ukraine and Russia. Some companies may prefer to invest in countries that have institutional similarities, so the restructuring may have increased the location advantage for Turkish companies (Neuhaus 2006, 145). Furthermore, in the civil servant's opinion, another argument may have been that the Ministry of Energy was better equipped and more experienced at handling major projects, and therefore it would be more efficient if the ministry also dealt with the licensing. However, he strongly objected to the term “power ministry”, saying that such a thing only existed in the soviet past.

The Ministry of Environment Protection has been criticised for its lack for professionalism (Jones 2013, 262). During the soviet period the Ministries were plagued with corruption. With deregulation, a reduced amount of permits and simplified procedures, the fight against corruption has been a success. One concrete illustration of this is the fact that many

¹⁷ Post-election 2012, this looks as will be changed again in 2013, as the natural resources department will be transferred back to Ministry of Environmental Protection (civil.ge).

experienced but corrupt officers have been removed from state positions (GA 2011, 31). On the one hand, this was an effective method of getting rid of unreliable civil servants. On the other hand, however, the ministry now has fewer experienced employees, and the inexperienced staff who remain may make ill-informed decisions (GA 2006, 38). Accordingly, the ministry has been criticised for not fulfilling all its obligations. Green Alternative even stated bluntly that the staff members at the ministry are “inexperienced and incompetent” (GA 2011, 31).

The civil servant at the Ministry of Environment Protection said it had been a blow to the ministry when it lost the natural resources department. At the same time, he did believe there was some logic to it, since having all licenses under the same roof could promote effectiveness. In effect, the procedures are efficient and rapid, which is appealing for investors who are able to avoid time-consuming bureaucracy. Accordingly, the restructuring of the ministries may have increased the location advantage of Georgia over more bureaucratic countries.

However, the discussion of the Ministry of Environment Protection does not end here. The project coordinator at the Aarhus Centre said that the Ministry of Environment Protection has lost power year after year as new legislation has been introduced to create a business climate that is more suitable for development. During 2009 and 2010 there was a discussion regarding the abolition of the Ministry of Environment Protection, with suggestions about whether to reposition it as a department under some other ministry (Jones 2013, 263). This suggested downscaling of the Ministry of Environment Protection attracted heavy criticism from civil society and particularly from the environmental NGOs. The activist at Green Alternative believed that strong objections from a range of NGOs prevented the downscaling from taking place. According to the co-chair of the Greens Movement, who is also a former minister of environment protection, the organisation objected strongly because it saw the restructuring as a way of pushing environmental issues to the periphery of the political agenda. The coordinator at the Aarhus Centre asserts that the NGOs’ protests were successful since the ministry maintained its status.

The government’s priorities may also be noted in the national budget. For years the Ministry of Environment Protection has been at the end of the line to receive ministerial funding (Jones

2013, 236). The civil servant from the Ministry of Environment Protection objected to the notion that the environment was not an important issue for the government, although he admitted that it had not been a top priority. Changes since 2006 have made the Ministry of Energy and Natural Resources stronger. The civil servant at the Ministry of Energy and Natural Resources said that he personally believed that Georgia should develop the hydropower plants “even at the expense of the environment”. Of course, the environmental issues at stake should not be disregarded, but he believed that the greenfield hydropower constructions would have more benefits than drawbacks. In summary, ministerial restructuring may have improved the efficiency of dealing with greenfield projects, but one question that still needs to be asked is whether the changes might have weakened the Ministry of Environment Protection.

5.1.1 Legal framework

There is disagreement about whether the environmental laws are adequate to protect the environment in Georgia. Neither Green Alternative nor the Greens Movements see the legal framework as sufficient. However, at the Aarhus Centre, the coordinator is satisfied with the framework, but she stated that although the current legal framework meets the international EISA standards, there is a long way to go before access to information is ensured. The director of Gamma Consulting agrees with the Aarhus Centre that the legal standards are adequate to protect the environment, and added that the Georgian legal framework has similarities with that of the EBRD. Further, the director stated that his company tries to act in accordance with international conventions, but they are also dependent on the “style of the investor”. He said that each company had its own style and approach, which was something the company respected as long as they were in accordance with the Georgian legal framework. The Norwegian investors in the AGL project consider the laws and regulations adequate for protecting the environment. An environmental NGO expatriate working in Tbilisi agreed with this, noting that the laws are in place but the challenge lies in monitoring and enforcement.

Having laws and regulations on paper is one thing, but equally important is the practical implementation of this framework. The civil servant at the Ministry of Environment Protection reported that the situation for the ministry was not as bad as the NGOs sometimes

depicted it (e.g. in GA 2006), but he admitted that budgets had decreased due to structural changes. In consequence, the ministry was faced with challenges in terms of monitoring the construction projects, caused by the fact that they did not have enough staff. This has been the case for some years, the civil servant noted. According to Jones, ensuring the implementation of the law is difficult without the ability to monitor behaviour (2013, 262).

As a report from Green Alternative states, this situation leads to “a neglect of environmental concerns when making important decisions” (GA 2011, 31). The activist interviewed at Green Alternative asserted that the legal reforms since 2006 have been “business orientated”, with the further implication that the government had not given environmental issues much attention. The co-chair at the Greens Movement raised the unanswered question of who would be responsible if construction led to environmental disasters such as landslides. The informant at AGL said that the company had not written specifics on the issue in the contract, but stated that the company would compensate if the project was ever proven to have contributed to substantial environmental harm. The activist at Green Alternative noted that the issue of compensation was important, particularly in the light of a legal amendment introduced in March 2012. This amendment enables the Ministry of Energy and Natural Resources to negotiate with private companies about financial compensation for environmental harm. In practice, the state gets financial compensation in exchange for not taking legal action against the company (GA 2012b,8). Green Alternative argues that the law contradicts the Aarhus Convention, as it does not promote a transparent framework, but rather promotes behind the scenes negotiations between companies and the government (*ibid.*)

The activist at Green Alternative thought this was unfortunate as it demonstrated that the government is more concerned with revenue than with environmental protection. The NGOs thought the law was unacceptable in terms of sustainable development since it left the door open for corrupt deals and the neglect of environmental protection (GA 2012b, 2). In addition, the NGOs claim that the law was quickly drafted and was implemented without external consultation (*ibid.*). The interviewee at the Energy Efficiency Centre took a more pragmatic approach, believing that the most important issue was for the government to receive compensation for situations where construction projects cause damage to nature. Revenue is important for Georgia. Still, such a legal framework might indicate that it is easier to get or

buy forgiveness than it is to obtain environmental permissions, a point we will come back to. First, however, the environmental impact of the projects will be discussed.

5.2 ESIA reports

An Environmental and Social Impact Assessment (ESIA) evaluates the potential impact of the construction and operation of hydropower projects. It projects environmental impacts and tries to avoid or mitigate them (Boyle 2004, 413). The ESIA documents are available in both Georgian and English. Both cases are the subject of comprehensive reports that address a range of issues, but I will not go into detail here (for further information see Gamma 2011 and MacDonald 2012). Instead, I will discuss the framework of the EISA in connection with the cases.

The coordinator at the Aarhus Centre said that the legal basis for granting environmental permits is satisfactory, since it clearly sets out the procedures required. There are some drawbacks, she noted, but the framework itself is adequate. The main drawback, according to the project coordinator, was that the government had chosen not to carry out ESIA for all hydropower projects. While smaller projects under 13 MW tend to have less social impact, they may still cause relatively large environmental consequences (Bakken, Sundt et al. 2012, 41).

Regarding the two cases under examination in this study, both projects are labelled as so-called run-of-river projects (UNFCCC 2006). Run-of-river hydroelectric is a type of generation where the natural river flow is utilised and little or no water storage is necessary (runofriverpower.com 2012). In this case, the classification refers to the limited amount of water storage (reservoirs) in the hydropower projects. The advantage of having smaller reservoirs is that they have less impact on the surrounding environment and municipalities. Therefore, they generally have a much smaller social and environmental impact than traditional large-reservoir hydropower projects. Also, this model reduces the likelihood that local communities may lose their houses or farmland (runofriverpower.com 2012). However, a technical drawback is that there is little possibility to adjust electricity production according to demand. The plants will generate according to seasonal flows, and therefore the power

production will be higher in the spring months. As the water storage volume is small, this model does not reduce the flood risk in the region.

The company Gamma Consulting prepared the ESIA for the Ajar project. According to the director of Gamma Consulting, the ESIA report for the Ajar project was carried out in accordance with both Georgian guidelines and those of the EBRD (European Bank of Reconstruction and Development). A three-step cascade is planned, where the reservoirs will be 0.46, 0.88 and 0.90 km² for each step, respectively (UNFCCC 2006, 34). No diversion tunnel, pressure pipe or the like will be needed, a feature that reduces environmental impact. There will be fish passages for all the dams so that fish can travel upstream and downstream in the river (Gamma 2011, 89). The hydropower cascades will operate using water from the Chorokhi River and on the regulated water of the Adjaristsqali River (since the Ajar hydropower plant is downstream of the AGL project's planned plants). The ESIA report states that the impact on wildlife will be of a temporary nature, with the area returning to normal when the construction works have finished. Some local climate changes are expected near the reservoirs, such as increased humidity (UNFCCC 2006, 34).

According to the EISA, the hydropower plants will not have any significant impact on the Black Sea coastline. This is due to the fact that the Machakelistkali and Adjaristsqali rivers have a limited role in sediment transporting, and the Chorokhi no longer transports sediment (UNFCCC 2006, 35). On this point, however, the environmental NGOs Green Alternative and the Greens Movement disagree with the report. Both organisations expressed concern about the projects' impacts on the sediments of the river, and the impact on the Black Sea coastline has been a major issue, a view shared by the local municipalities (UNFCCC 2006, 36). The co-chair at the Greens Movement was particularly sceptical, since this organisation believes the construction of the plants will decrease the fish population, which would be particularly critical for the Black Sea salmon. Hydropower projects are known for causing difficulties for fish movement (Hanley and Barbier 2009, 296). The director of Gamma Consulting does not think this is likely to happen because there will be fish passages built into all three dams. The environmental studies done by Gamma Consulting claim that the Ajar project might have an impact, but that it will be insignificant (see ESIA by Gamma 2011). Nevertheless, the NGOs and the local population remain sceptical, despite the statements of the ESIA.

Regarding the AGL project, the British engineering company Mott MacDonald conducted the ESIA studies, while Gamma Consulting conducted the pre-studies. The CEG and the IFC both financed the studies, for which the estimated cost is approximately 12 million USD. The company states that this ensures “international best practice”, which is part of the project’s operational policy (UNFCCC 2012, 52). The outline of the operational phase of the AGL project states that it will develop a system to manage environmental and social impacts, according to international standards like the ISO 14001¹⁸. In the ESIA, all the potential impacts have mitigation suggestions to avoid or reduce the effects. This is in accordance with both national laws and international standards, particularly the IFC guidelines. The activist at Green Alternative said that the AGL projects tries to conduct these studies properly, in contrast to several similar hydropower projects in Georgia. The Ajar project will flood an area of about 0.64 km², with parts of the flooded land being owned by the local population. As the AGL project has a small reservoir, the changes to the local climate are believed to be insignificant (*ibid.*, 60). However, several locals have expressed concerns that the project will cause ecological deterioration (*ibid.*, 57). It is understandable that the population is sceptical towards the easy dismissal that the project will “not cause substantial damage” (*ibid.*). One characteristic of hydropower construction is that some of the consequences are irreversible, and this has been a cause for concern among the local population (Hope and Skjeret 2008, 3).

Another issue is seismic activity. Indeed, the South Caucasus is one of the world’s most seismically active regions (Müller-Kraenner 2008, 116). A major earthquake could damage pipelines and hydropower plants, which could potentially lead to environmental harm, with oil spillage and flooding in worst-case scenarios (Müller-Kraenner 2008, 116). At the same time, the likelihood of these scenarios is low, and potential investors tend to avoid very risky projects. Nevertheless, the mountainous areas of Ajara are prone to mudslides, and these do occur, resulting in loss of agricultural lands, houses and sometimes even lives (civil.ge 2008). In 1989 a mudslide displaced thousands in Ajara (Curtis 2004, 105). Yet it is unlikely that the two foreign companies would invest if they considered the environmental risk to be high.

¹⁸ A series of environmental standards, established to help to avoid/minimize negative effects on the environment (energy saving).

5.3 Licensing

In order to get a construction license for hydropower plants over 13 MW, the ESIA must be sure that no significant environmental harm will result, and there must be measures in place to avoid any potential effects. Also, the land acquisition process must be completed. The activist at Green Alternative said that the government thought of business before environmental protection, and he believed the issue of licensing illustrated this. He pointed to the example of the Dariali hydropower project, which is similar to the two cases studied here in that it is also a result of the energy strategy since 2006 (menr.gov.ge). The project is financed by the United States and will cost approximately 135 million USD (georgianamerica.com). According to Green Alternative, the construction works started without the necessary permits from the government, meaning that the project began construction without a license. In addition, parts of the construction works were located in a national park. Thus, when the Ministry of Environment Protection gave the project permission to operate, in fact the ministry broke the law since it is illegal to construct in such areas. Green Alternative protested, but the Georgian authorities have not reacted or punished the hydropower company for starting construction in a protected area without a construction license (greenalt.org 2012b).

Interestingly, a somewhat similar (although less controversial) situation occurred in one of the cases studied here, since the Ajar project also began construction without receiving a construction permit. The company's PR manager neither denied nor confirmed this. Nonetheless, the timeline for the start of construction and the date when the company was awarded the license indicate that this situation is likely to have occurred. The construction phase started in October 2012, with pre-construction works beginning in the spring of 2012. However, the authorities granted them a licence in November that same year. This indicates that the Ajar project started construction before it received a construction licence. In this case as well there has been no penalty for starting without obtaining the correct license. Green Alternative believes that this demonstrates that the government is more eager to get projects off the ground than to ensure that the population and environment will be safe from harm.

In contrast, the AGL project did not achieve its intended timeline for obtaining the same license, and the company was threatened with fines due to the delay. According to a civil servant at the Ministry of Energy and Natural Resources the AGL project would be fined, but

as of April 2013, no fine has been issued. Therefore, it is not clear whether the AGL project will eventually have to pay a fine due to the delay. The ministry has the power to fine companies that are delayed or where the development process has become stagnated. The civil servant at the Ministry of Energy and Natural Resources stated that the ministry expects the companies to complete the projects on time. If this does not happen, the ministry will take some of the money out of the company's bank guarantee to use as a source of pressure. Moreover, he stated that the Ministry had previous experiences with projects that had stagnated, and without the bank guarantee there was little the authorities could do. Therefore, it was important to have a means of ensuring that projects will develop. Fining based on bank guarantees empowers the authorities to force the foreign companies to start and complete projects within the contracted timeline. He also stated that this proves to foreign companies that Georgia is serious in its efforts, and is willing to "push them to work harder". He added that the ministry has a "flexible approach" and that the completion of projects was indeed more important than meeting deadlines.

Yet it is curious that the project which started without a license has not faced any consequences, whereas the project that received licences, albeit late and despite continually working for them, has been threatened with fines. The two civil servants at the Ministry of Energy and Natural Resources said that they did not know the Ajar case and therefore they could not give an answer to this question. The activist at Green Alternative believed that perhaps the local authorities gave signals to the company that construction could start, even without the license. If so, this may indicate that the government prefers progress in construction rather than ensuring that environmental and social issues are being dealt with in a proper manner (GA 2012b, 3).

The project coordinator at the Aarhus Centre also noted that there had been previous hydropower projects that started before the ESIA was completed, meaning that the construction works started before mitigation measures were implemented. This increased the possibility that the projects may have caused negative consequences that could and should have been avoided, if the proper time had been taken to put mitigation measures in place. The project coordinator further stated that this demonstrates a "pro-development approach" on the part of the Georgian government. More precisely, she defined this as the government ignoring some environmental issues in order to make it easier for businesses to start operating. As a

report from Green Alternative states, “conducting an environmental impact assessment after the launch of the activity is absolutely useless” (GA 2006, 27). At the end of the day, the Georgian authorities are responsible for the legal framework, and for ensuring that no company breaks the law and those who do are punished.

5.4 FDI and the environment

Many developing and emerging economies, Georgia included, have high hopes that FDI will generate economic growth (Zarsky 2005, 39). As discussed in the theory chapter, the effect of FDI on the environment depends on where it is, when it occurs and who is conducting the investment.

The increasing number of regional and bilateral agreements in the last decade has promoted liberalisation and FDI flow. Generally, the agreements focus on the rights of the investors, but fail to articulate environmental or social responsibilities, either on behalf of the investor or the government (Zarsky 2005, 26). Some countries, including Georgia, lack the capacity or the political will to monitor environmental protection (GA 2006, 10). Hence, the companies themselves play a vital role and have several options for how they choose to conduct their practice. For instance, the company can choose to comply with local regulations, or it can choose to follow “international best practice” (Zarsky 2005, 28). This thesis argues that the Ajar project is an example of the former, while the AGL project is more in line with the latter.

A report from Green Alternative (GA 2006, 28) states that it is generally better to have international finance institutions involved in the FDI projects. This is because such an involvement means the projects are not only obliged to follow national standards; they must also adhere to international standards, and in terms of environmental protection, the NGO values these standards higher than the Georgian legal framework. An example of a company following high standards is the AGL project in which the IFC is a co-developer, and this is reflected in the company’s policy (cleanenergygroup.no 2011b). The activist at Green Alternative stated that the AGL project was different since the company had a serious and comprehensive approach to pre-construction studies and the ESIA process, unlike most of the current greenfield hydropower projects in Georgia.

However, even if the AGL project has “higher” environmental standards, this only affects that individual project, and it is unlikely to have significant influence on the national policy (GA 2006, 28). This may indicate that FDI can improve environmental and social standards if the investor embraces the principle of environmental responsibility (Zarsky 2005, 15). For international financial institutions, there seems to be an increasing concern about environmental issues. Backing from the IFC and the World Bank comes with certain environmental and social responsibilities attached (Zarsky 2005, 109–110). Therefore, the AGL project’s environmental stance not only reflects moral concerns, but also legal and financial concerns because the company is subject to pressure from the IFC (*ibid.*, 109–110).

The net effects of FDI on the environment depend on several factors, such as industry and company policies (Zarsky 2005, 39). The hydropower sector is not the worst polluter; except for emissions in the construction phase, hydropower plants are usually seen as environmentally friendly (Hanley and Barbier 2009, 285).

5.5 Employment

In an effort to promote hydropower developments among the Georgian population, in 2012 the government advertised that the new hydropower plants would create thirteen thousand new jobs (myvideo.ge). At the Ministry of Energy and Natural Resources, the head of the Investment Projects division listed the creation of jobs as the main benefit of greenfield hydropower projects. This section will discuss the labour market situation and employment opportunities in the two cases.

One of Georgia’s major struggles since independence has been the situation in the labour market, particularly the high unemployment rate. According to the EDBI the labour market is classified as “flexible”, meaning it is easy to hire and fire employees and working hours are flexible (doingbusiness.org 2013b). Georgia is known for having one of the most liberal labour codes in the world, but it is open to debate whether the liberal framework improves the labour market in Georgia (nbiexpo.com).

Although Georgia has a high literacy rate of 99,7% and a large percentage of the population is educated at university level, there are challenges. In addition to patterns of long-term

unemployment, there has been a high labour migration rate since independence, and the skills are outdated (Jones 2013, 201). For a large proportion of the population the labour market consists of few jobs, low wages and weak labour protection (Jones 2013, 203). Hence, a positive effect of FDI would be the creation of new and stable employment opportunities for the local population. Indeed, countries that attract and retain FDI are able to improve the employment situation in the country, although this is not something that will happen automatically (Lee and Vivarelli 2004, 337). Foreign companies can employ people directly, but FDI can also have an indirect affect by creating jobs among suppliers and in the service sector (Lee and Vivarelli 2004, 376–7). Jones (2013, 181) asks if FDI in Georgia will lead to the “retention of native skilled personnel and provide training for future industries”. He doubts that it will, arguing that the preconditions are not there in the case of Georgia, e.g. when it comes to the labour code (*ibid.*).

In Georgia, the labour code has changed dramatically since the revolution, although from 2011 there has been no further reform and neither has the minimum wage increased in years (doingbusiness.org 2013b). The minimum wage for workers and apprentices still stands at 21.7 USD/month (WB 2013, 101). The amendments to the labour codes include “making the cost for hiring and firing workers very low” (investinbatumi.ge 2012). The aim of the amendments was to decrease the unemployment rate within the labour market, but the liberal reforms have not helped to reduce the high rate (Shvelidze 2012, 16). While limiting the rights of employees, the rights of employers have been substantially broadened. As Papava notes, this might encourage business to develop, but on the other hand it also leaves employees unprotected (2006, 201). One could thus argue that the labour code might be good from an investor’s point of view, but it is not helpful for an employee to get few benefits and weak contract protection (Jones 2013, 202). Interestingly, two Georgian employees at AGL’s Batumi office said that one of the benefits of working with the projects was employment stability. They perceived this benefit despite the fact that at the time the project had not reached financial closure, and nor had it obtained a construction license, which still meant that the project might not go ahead. This reflects the instability of the Georgian labour market rather than a certainty that the project would move forward.

Officially the unemployment rate in Georgia stands at 15.1%, while the unemployment rate in Ajara stands at 16%, a little above the national average (geostat.ge 2011). The numbers do not

reflect the realities of the labour market, as the Georgian Law on Employment defines anyone living in a rural area with one hectare of land as self-employed. Accordingly, a large percentage of farmers are classed as employed even though they are living at a subsistence level. Therefore, Jones (2013, 202) argues that the high level of rural employment is a statistical manipulation. The rural population classed as employed do not pay taxes, but then again they are deprived of state benefits (Jones 2013, 202). Additionally, the statistics do not reflect the general perception of the population. In a survey from 2011, 67% of the people considered themselves unemployed (Jones 2013, 202). The definition of employment might make the labour situation Georgia look acceptable, but it avoids addressing the challenges of economic and social development.

5.5.1 Hydropower and employment

There is reason to believe that the actual unemployment rate is high in the rural regions where the two hydropower projects are constructed, so that job training and employment possibilities could be changes for the better. Both projects state an intention to improve the affected communities by offering temporary and permanent jobs (UNFCCC 2006, 3). While the construction phases of the projects may offer employment possibilities, many of the jobs are short-term in nature and it is not clear how many permanent jobs will be created. In the context of constructing hydropower schemes, it is worth noting that potential growth areas such as construction are often divided into time-limited projects and accordingly, hydropower projects are not major long-term employees (Jones 2013, 202).

In addition, the interviewee at Green Alternative noted that while many jobs will be created, it is not certain that Georgians will be employed. He pointed out that foreign workers have conducted many of the recent major construction projects in Georgia. An example from Ajara is the construction of several five-star hotels in Batumi, where Turkish entrepreneurs and mainly Turkish workers have been involved in the construction works. Georgia is a member of the International Labour Organisation, and investors are guaranteed permission to hire foreign workers who are permitted to transfer their earnings abroad once they have complied with Georgian duties (nbiexpo.com). Flexibility of labour across borders might be a location advantage for investors; for example, it facilitates the movement of Turkish workers, who are considered highly skilled and relatively cheap.

Some Georgians have expressed discontent with this development (georgiatimes.info). In other construction projects the Georgians who were employed have not been content with the working environment under foreign management (vestikavkaza.ru). Transparency Batumi noted that some companies involved in hydropower construction would probably hire Georgian workers, since this would be a useful social policy for improving the working relationship with local authorities and municipalities. The head of the Investment Projects Division at the Ministry of Energy and Environment believed that Georgia would benefit if foreign investors employed Georgians. He said that in several cases this provision was included in the project planning, whereas in other cases it was put forward as a recommendation from the ministry. He further stated that it makes sense for foreign investors to employ locals, since by doing so the risk that affected municipalities might object to the hydropower project would decrease. The interviewee at Green Alternative suggested that requirements should be stated in contracts with foreign companies to ensure that a certain percentage of locals must be employed, as this would guarantee at least some benefit for the Georgian population.

Still, regulations might not be the answer. As the director of Gamma Consulting noted, it would be difficult to follow up on whether the companies have employed Georgians or not. The liberal laws and the current labour market do not provide Georgian employees with much job security, as noted earlier in this chapter. It is easy to write false contracts and it is easy to fire workers. The head of the Investment Project Division at the Ministry of Energy and Natural Resources admitted that it would be a challenge to control how many local workers were employed and for how long a period. The coordinator at the Aarhus Centre agreed with this assessment, but stated that if Georgians were not hired during the construction and operation of the plants, it would be hard to imagine anyone in Georgia besides the investor benefitting from the greenfield projects. The next section will take a closer look at the employment possibilities in the two cases.

5.5.2 Employment in the projects

The Ajar project has hired local Georgians both at the main office in Batumi and at the construction site. According to the PR manager, in March 2013 the company had approximately five hundred people working on the project. At the time of the interview the company had entered the construction phase of the project, hence the large number of workers. She said there were roughly equal numbers of Georgians and Turks working on the construction of the hydropower plants. Most of the Georgians came from Ajara, and several of them were from the affected areas. The PR manager said the company aimed at hiring as many Georgians as possible, but noted that it had been a challenge to find enough skilled Georgians in the local areas.

The company has also contributed indirect employment, for instance by hiring the Georgian engineering company Gamma Consulting to conduct the social and environmental studies for the project. The projects has utilised Georgian expertise, in contrast to the Ajar project that chose to cooperate with an international engineering firm. The anonymous interviewee said that Gamma Consulting was the best Georgian option for these assignments, but nevertheless the company's standards were not excellent. International companies may be better equipped to handle hydropower evaluation, something that might suggest a contradiction between economic (jobs) and environmental interest when conducting environmental studies. The Ajar project indirectly contributes to the labour market by supporting a sector outside construction and uses Georgian employees with high technical skills (Lee and Vivarelli 2004, 376–7). The director of Gamma Consulting noted the lack of skills in demand among Georgians, particularly at a high level. He said that the Gamma trained its employees and university students, but this was only on a limited scale.

In November 2012 the informant at AGL project said that the company currently employed somewhere between thirty and forty Georgians. This number would increase significantly when the construction phase of the project began. In addition to the main office in Batumi the AGL project has also opened an office in one of the affected villages, where locals have been hired. The AGL project has conducted so-called skills mapping in the affected areas to map the skills of the local population. The map showed that there was a demand for training in the area, and that, perhaps unsurprisingly, there was a large amount of interest in the employment

possibilities the company said it would offer. Furthermore, the skills map might have served to promote employment opportunities, thereby positively influencing the population's perception of the project. Nevertheless, what makes this project stand out from most other greenfield construction projects is the vocational training that the company offers to a section of the local population.

On February 1, 2013 the AGL project opened a vocational training centre in the municipality of Shuakhevi. According to the informant at the AGL project, the aim of the centre is to train local residents in different construction skills and provide courses that could lead to employment during the construction of the hydropower project. The courses have a two-months duration, are practically oriented and are run by instructors from a vocational college in Ajara. The total cost of the training is financed by the AGL project, and the first round of training offers courses for welders, electricians and heavy machinery operators. The training centre has recruited forty-five locals so far and they are well into their training, according to the AGL informant. The next course started in April 2013 with the training of general labourers. By summer 2013 the AGL project intends to run two shifts and train ninety students at the same time, and the plan is to train approximately six hundred local residents in total (adjaristsqali.com 2013b).

As noted by both companies, there is a lack of skilled Georgians, which is a challenge that prevails in the entire country. A survey from 2008 among foreign investors in Georgia singles out the lack of trained and available workers as the largest obstacle in the way of investing in Georgia, and the lack of skilled workers in technical jobs was particularly noted (Gursoy 2008, 23–24). The Georgian vocational education system fell apart after the break up of the Soviet Union, leaving the sector with an outdated curriculum and courses that did not reflect the current and future demand for skills (Haug 2012, 9). Reform measures were introduced in 2005, but the reforms did not deal with all the problems related to the outdated vocational training sector. With several large construction projects happening all over Georgia, the government has done too little to update the skills and education of the population, with the consequence that fewer Georgians are able find employment in construction developments.

Since independence, Georgia has not paid enough attention to vocational and technical training, which is unfortunate for investors who will have difficulty finding skilled local

workers. It is also unfortunate for Georgian workers who are seeing more foreigners employed in construction projects in Georgia (Gursoy 2008, 32). Several foreign companies have stated that they intend to hire Georgians but they do not follow through in practice. The reason may be the lack of skilled Georgian workers, combined with easy access to a foreign workforce. For instance, it would be simple for the Ajar project, as a Turkish company operating close to the Turkish border, to find the work skills needed just over the border. In addition, another consequence that can be seen all over the construction sector in Georgia is that it is usually only foreign companies that are ready to compete in tenders, and they might tend to hire foreigners over Georgians (Gursoy 2008, 24).

In conclusion, Jones might have been right in being sceptical of the notion that FDI will improve the labour market situation in Georgia. As discussed above, there is a lack of skills, and the current labour code leaves employees vulnerable. Nevertheless, the projects have offered employment opportunities for locals, and thus have had a positive impact on the local municipalities. By offering vocational training, the AGL project enhances the employment possibilities in the development, and perhaps in future construction projects elsewhere in Georgia. The final part of this chapter will deal with the relationship between the foreign investor and the local population.

5.6 Local stakeholder consultation

Public meetings are conducted during the EISA phase, as required by law. The meetings are held by the companies and not by external experts in the field. In the public meetings the affected population gets the opportunity to express their views directly to the investors, which is in accordance with the Aarhus Convention. Nonetheless, Green Alternative does not consider the meetings to constitute participation in the decision-making process; rather, they appear to function as information provision. According to Green Alternative, most decisions have already been made prior to the public meeting. The law provides access to information, but in practice there are several shortcomings (GA 2011, 41–42). The coordinator at the Aarhus Centre stated that the poor level of information available to the local population was a challenge in the greenfield construction projects.

According to the associate professor interviewed for this study, the local population might have historic reasons to distrust what they have been told by the authorities and remain sceptical of companies' promises. While distrust of politicians can be found all over the world, some of the causes and consequences in this situation relate to Georgia's status as a post-soviet society (Rose 2009, 211). Some of the frequent concerns related to the planned construction works are the increased risks of potential flooding and landslides (UNFCCC 2006, 37). In the past, locals who have been forced to move due to environmental disasters have often been discontented with their new locations (humanrights.ge). As mentioned in Chapter Four, there is no clear resettlement policy, which leaves the population vulnerable. Therefore, it is understandable that the population is sceptical of the greenfield hydropower projects. Still, it is unlikely that companies would invest if they knew there was a considerable risk of natural disasters, as this could be costly. The law also prohibits any harmful projects from moving to the construction phase.

5.6.1 Public consulting in the cases

Both projects have conducted several public meetings and provided information in the affected areas. The main questions of concern were related to the risk of landslide, employment possibilities and resettlement issues. The question of the implementation of a reduced electricity tariff for local residents was also brought up (UNFCCC 2012, 54). Nevertheless, the interviewee at Green Alternative said that the NGO is not satisfied with the level of information, because the people in the affected area remain sceptical and concerned. The Greens Movement also believed the information received by the affected population in the larger construction projects tended to be insufficient. Both companies have held public meetings in the affected areas as required by law. Still, there have been incidents that illustrate that information has not always been available, and hence the affected population is left out of the decision process.

The spokesperson at the Ajar project said that they had conducted public meetings as required, but apart from these events the company have not held any other meetings with the local population. She said it was not something that the company found particularly useful for either stakeholder. The company found other methods to be more constructive, and has hired a person who lives in the affected area to communicate information from the Batumi office to

the local municipalities. Thus, most of the communication was done through a third party and there was little direct communication between the company and the local population..

The officer at Transparency Batumi said there had been an incident with the Ajar project where a lack of information had caused discontent amongst some of the local population. The Ajar project had an unfortunate occurrence where they marked the planned reservoirs without consulting the affected population first. In April 2012, some of the locals found marks in their gardens and were angered with the company for trespassing on their private property and also shocked at how close the water of the reservoirs would be to their houses. Not surprisingly, the affected population felt left out of the decision-making process. As both the Greens Movement and Green Alternative point out, it is most common that the locals are informed after the decisions have been made. Thus, they have little opportunity to influence the decision-making process. According to the officer at Transparency Batumi, the local population was also worried about compensation, about which at the time they had heard nothing. She stated that she did not believe this was intentional on the part of the company; the company had said that it assumed the local authorities had informed the municipalities. Transparency Batumi considered the Ajar project to be open to communication, and deemed the incident an honest mistake. Even if it was not intentional, however, such an incident should have been avoided because it created suspicion among the population. The incident shows that adequate and timely information for the affected population is vital, and a lack of it can cause unnecessary worries. It also illustrates the poor level of information received by the local people, and Transparency Batumi believes that these sorts of incidents can lead to mistrust of both the local authorities and the foreign company involved, but they can and should be avoided.

When it comes to the projects' relationships to the population, AGL operates closer to the principles of the Aarhus Convention. This probably has to do with that fact that the IFC is a part of the project, and thus the company follows IFC standards. IFC influences is reflected in several areas, including the relationship with the affected population, e.g. in terms of access to information; as the IFC states, "transparency is essential to building and maintaining public dialogue" (ifc.org). The informant at the AGL project said that the company had placed letterboxes in the affected municipalities, which the locals can use to address their questions about the project and express grievances. Every second week, someone from AGL goes up

to the valley to check the boxes, but the company has hardly received any letters. This is perhaps because a letter-writing provision does not reflect the realities of mountain regions, since most Georgians prefer to call when they have questions¹⁹. Indeed, the AGL informant said the company have received several phone inquiries, and the questions were more or less the same as the ones asked when the company conducts a hold public meeting. The AGL reports that almost all villages seemed positive, though this is likely due to the prospect of training and employment opportunities.

The AGL project held several public meetings in the affected areas in June 2012. Through invitations in the local media, the local stakeholders were invited to attend the meetings to obtain information and ask questions. Other interested parties, such as the interviewee at Green Alternative, also attended (UNFCCC 2012, 54). The employee at the AGL office said that some of the affected population had expressed concerns about the possibility of landslides. They wanted guarantees that the construction work would not cause landslides, and if it did, they wanted to know how the company planned to compensate the local municipalities.

The difference between the approaches in the two cases leads to the question of why companies choose to follow different approaches in the same setting. The Ajar project abides by its obligations according to the law, but does little more. Of course, it is up to the Georgian authorities to set adequate standards, following them up with monitoring and punishment if the projects do not live up to the standards. However, the AGL project has standards that might be considered higher than the national law code.

Concerning public relations, the AGL project might have incentives to act according to “best international standards”, while the Ajar project may not have the same incentives. An example would be the projects’ relationships with the press. There are more controversial projects in Turkey (guardian.co.uk), and therefore it is unlikely that this project will attract any press in the home country. For the AGL project, negative media attention might be a slightly more important issue. The media in Norway is keener on exposing Norwegian companies’ misconduct abroad. Indeed, in 2011 one journalist published an article in the online version of a Norwegian newspaper. The article was soon withdrawn because the

¹⁹ Phone is a by far the most effective way to get a hold of someone in Georgia. Not all answer their mail but everyone seems to answer their phone, something also experienced under my stay in Georgia in November 2012.

journalist could not prove his statements, but nevertheless, even unfounded accusations might harm the project. The AGL project has a stronger motivation for acting well and receiving good press reviews. The project is an IFC co-operation, and if the project is badly conducted, the worst-case scenario would be that the IFC/World Bank might pull out. Being the very first project conducted by the company, it is likely that the management team will wish to be able to exhibit a successful project. An ownership advantage might include a good reputation (Bjorvatn 2001, 2), something that would come in handy should the companies desire to enter further hydropower tenders in Georgia in the future.

5.7 Conclusion

The findings in this chapter suggest that environmental protection has not been a priority for the Georgian government and that the greenfield development has not contributed to putting the environmental issues higher on the political agenda. In fact, the empirical evidence shows that the eagerness to start on the greenfield hydropower projects has overshadowed environmental concerns. In the two cases, this was illustrated with the issue of construction licensing, where the Ajar project started construction without the necessary license but was given no consequences. In contrast, the AGL project was threatened with fines for not abiding by the planned construction start date. Nevertheless, as all stakeholders interviewed, apart from the two local NGOs, believe that the environmental legal framework is adequate. Still, the real challenge is the implementation and the monitoring of environmental protection.

Regarding the Georgian workforce, both companies have noted a lack of skilled local workers. Yet both companies have employed local Georgians because this is part of the companies' social policy.. The AGL project has dealt with this by establishing a vocational training centre in a village in the affected region. This is further related to the AGL project's social profile, which is influenced by the company having the IFC as a co-developer.

6 Concluding remarks

In this final chapter I will present the main findings of the thesis. I will return to the questions asked in the introduction and examine them in the light of the theoretical framework and the empirical data. The main research question was in what ways the search for FDI in the hydropower sector have an impact on the society. In short, the findings indicate that some environmental and social aspects have come in the background in terms of political prioritising and the neoliberal-inspired reforms implemented in order to promote greenfield hydropower development. A more in-depth discussion follows below.

After the Rose Revolution, several sectors in Georgia went through considerable change, including the electricity sector. This thesis has argued that Georgia has followed a neoliberal inspired policy path since 2003, which can be observed in the deregulation and simplification measures introduced and the impressive climbing in the EDBI. In 2006 the government declared its intention to utilise the domestic hydropower potential. With policies such as reducing bureaucratic procedures and announcing a call for international tenders, reforms in the electricity sector were clearly aimed at attracting FDI. The reforms yielded quantitative success since the country soon managed to attract several foreign investors, including the two cases examined in this thesis. Nevertheless, some of the stakeholders have expressed concerns about the developments, saying that the government has been too business-friendly and questioning the need for and the reasoning behind the large-scale greenfield hydropower developments that have been commissioned since 2006.

Like many other emerging economies, Georgia has high hopes for FDI's effect on economic growth. However, as shown in the theory section, the relationship between FDI and economic growth is not automatically beneficial, and there is no certainty that FDI will improve the economic, social or environmental situation in Georgia. The stable supply of electricity even in the winter months is an achievement, but it does not solve the overall question of energy supply. As electricity only accounts for a quarter of the country's total energy consumption, any additional FDI greenfield capacity will only have a limited impact on energy diversification. Moreover, it is still too early to foresee what impact the hydropower projects

will have, for example it is difficult to estimate the exact revenue income from property taxation from the two companies.

The comprehensive reforms in Georgia have not gone unnoticed by the rest of the world; one great achievement was being named the number one reformer in the world by the World Bank. Georgia is perhaps the best regional performer, but the accolade of the globe's best performer might seem to be somewhat of an overstatement since the statistics do not always reflect the reality. There are many benefits of doing business in Georgia – streamlined bureaucracy, reduced corruption and so on. Still, as this thesis has argued, it is not as easy doing business in Georgia as the EDBI suggests. Perhaps it is time to look for inspirational sources other than the Washington Consensus-based approach of the EDBI. Georgia's strategy for attracting FDI had been inspired by neoliberal ideas, and since the country already had secured several hydropower investments, now is possibly the time to be more selective in terms of announcing new project tenders and choosing the companies that will be granted concessions. Still, Georgia must remain an attractive investments destination if it wants to successfully compete in the global competition for FDI.

Chapter Four started with examining the reforms Georgia has implemented in order to become an attractive location for greenfield hydropower projects. The OLI paradigm, combining the local advantages of Georgia with the ownership and internalisation advantages of the two companies, helps to explain why the two companies choose to become foreign investors in Georgia's greenfield hydropower sector. Yet, it does not explain why Georgia should opt to attract investors, nor does it deal with how the state should benefit from FDI. As discussed in the theory section, the neoliberal approach assumes an unquestioned belief in FDI. With few regulations and low taxation, the potential spillover effects of the FDI hydropower projects depends a great deal on the companies themselves. This is in accordance with the neoliberal approach, in which a goal is to increase the company's influence and diminish that of the state. Some of the advantages in the OLI paradigm are discussed below.

As noted, domestic electricity demand could be satisfied by the rehabilitation of existing hydropower plants and energy saving measures, and accordingly the Georgian market is not particularly attractive. However, the location advantage of Georgia is significantly increased when the Turkish market is added to the equation. In addition to being a large energy market,

Turkish retail tariffs are higher than in Georgia, and growth rates have been high for years. Both projects will export most of the electricity they produce to Turkey, and for that reason the location advantages of the Turkish market have to be considered. Moreover, the location of the projects allows the companies to utilise their management and internalisation advantages. The two companies have certain expertise which gives them a comparative advantage over other potential investors – the Ajar project is close to both the Georgian and Turkish markets, and the AGL project has a former advisor to the Georgian minister of energy and natural resources in the company's management team. Nevertheless, there are also some challenges with operating in the Georgian electricity market. For instance, a drawback is that the tariffs in Georgia have been low, which is not beneficial for investors. Still, investors can negotiate a profitable price with the state agency GNERC. It remains to be seen if GNERC will honour its promised tariff rates to the investors, or whether it will be politically pressured to keep prices low.

According to the EDBI, Georgia is ranked thirty-third out of 185 countries when it comes to tax reforms. Simplification measures have increased revenue collection, and thus the tax reforms can be seen as successful, despite Georgia's relatively low score in the ranking. Regarding taxation one should keep in mind that greenfield hydropower projects are a long-term investment. Though two local environmental NGOs expressed beliefs that the developments would not generate much revenue, the estimates from the projects indicate otherwise; the tax revenues from property would seem to have a significant and long-term effect on income for the local municipalities. By attracting FDI the government will increase the budget revenue, which is a positive impact on the Georgian society.

In contrast to the tax ranking, the EDBI ranked Georgia first out of all the competing countries when it comes to property protection. In the light of the findings in this thesis, the EDBI ranking does not reflect the Georgian reality. Property was reported to be the most difficult issue by all the interviewed stakeholders, and the land acquisition process has proven complicated and time-consuming for both cases. It is reasonable to believe that this challenge is common to all greenfield hydropower projects that are located in rural areas, clearly including the two cases. Often the residents in rural areas have not registered their property; there are several reasons why this may be the case, but the main one is the difficulty of doing so. Selective land registration processes, for example when the affected population in the Ajar

project were suddenly able to register land just before the 2012 election and the following unsettled legal situation after the election, are not favourable either for foreign investors or for the Georgian population. This situation creates a level of political risk that makes Georgia less attractive for potential investors, and additionally prevents the Georgian population from gaining access to their legal rights. Despite the EDBI suggesting that property is not an issue, this thesis has shown that it has been the major challenge for all the stakeholders. The government's policy regarding property is though successful in one respect, namely ascending on the EDBI. However, the government has in reality introduced few real improvements.

Generally, the World Bank has shifted toward a so-called post-Washington Consensus policy, which is more socially inclusive. The organisation has a resettlement policy and acknowledges traditional land users. This policy could also be suitable for Georgia, where the population in the country's mountainous areas often lives on unregistered land. Influenced by the IFC and the World Bank, the AGL project does not distinguish between registered landowners and those who have been living on unregistered state-owned land. This approach is perhaps better suited for the Georgian reality than the EDBI ranking's one-size-fits-all approach. In addition, the government could consider a new resettlement law that protects vulnerable populations in rural areas. Protection of property right is at the core of a well-functioning market and Georgia is in this respect still struggling. As this thesis has shown, the status of property rights is unsettled, which affects the stakeholders in a negative way.

Chapter Five began with a look at how the developments in the hydropower related sector may influence the protection of the environment. Legal amendments and the restructuring of ministers suggest that the political drive for hydropower developments might have overshadowed environmental perspectives. The moving of the governance of natural resources to the Ministry of Energy might point towards a change in attitude, but it should be noted that there is nothing questionable about a government wanting to utilise natural resources. Several countries have hydropower departments governed by the energy ministry, Turkey and Norway included. What is more concerning is the issue of construction licensing, which is indicative of the government's attitude toward environmental issues. One of the main findings of the thesis was that the Ajar project started the construction phase without a license, but there was no penalty from the Georgian authorities for breaching this requirement. On the other hand, the AGL project was pressured to reach the construction

phase, as the company was threatened with fines for not achieving the planned construction start deadline. This is an indicator that the government is more focused on getting hydropower plants started than on protecting the environment in the development process.

Another finding was that the AGL project has a higher environmental standard than the Georgian legal framework. Nevertheless, it is uncertain whether one project can influence environmental policy at a national level. Still, if the government gives preference to companies with a “best practice” standard when granting concessions, this will in reality make an overall impact over time. The Ajar project mostly acts according to the national environmental framework, and as such it makes little impact on the environmental standards one way or the other. Neither of the two cases are likely to have a negative environmental impact. Both projects have taken their environmental commitments seriously, and no major harm is foreseen. At the same time, the main concern of local environmental NGOs is whether the projects will impact the Black Sea coastline. If the NGOs are right, the consequences will only become apparent once the hydropower stations are constructed. In terms of whether FDI has influenced environmental policy for better or for worse, the answer remains ambiguous.

The population will be affected in various ways. In the context of the government’s neoliberal approach potential spillover effects depend much on the companies’ policies and actions. One of the largest potential impacts on society will be the improvement of the unemployment rates, which has been a major struggle for Georgia. Employment opportunities will certainly be created with the greenfield constructions; the question is whether Georgians will be employed. Despite the government claiming they have skilled Georgian workers, the reality is that the skills are not available according to demand and the labour situation can be considered a challenge rather than a location advantage. When the AGL project decided to train locals it indicated that the company does not expect to find enough skilled local workers, but it was looking for a way to employ locals in the construction phase of the project.

Returning to the EDBI as a tool for comparing theory and practice, the index measures the “flexibility” of employment, and the Georgian labour code is very flexible indeed with regards to working hours and to hiring and firing workers. However, as foreign investors are

not legally obliged to employ Georgians, it is up to the companies whether they decide to do so. A difficulty is that the lack of skilled Georgians might contribute to the companies choosing to import the workforce required. Therefore, the AGL project's vocational training centre is an important measure to help the company employ local Georgians. The Ajar project also employs Georgians, and it had a more significant indirect effect by using a local engineering firm. The two cases in this thesis show that these greenfield projects could have a positive impact on development, because they both have a social policy of employing Georgians. However, while these particular cases are likely to have a positive impact, they do not necessarily reflect every other greenfield project. Yet another challenge is training at a higher level, and it will be interesting to see if there will be any spillover effect in terms of skills transferred from the more experienced Turkish and Norwegian employers to the Georgian employees. Generally, positive impact on local development will depend on if the hydropower investor chooses a predominantly local workforce over a foreign one. Consequently, the two companies in this thesis are likely to have a positive impact because they employ locals. Nevertheless, this outcome have not come about because directly from the government but rather from the companies' social policy.

The two companies have informed the local people according to their legal requirements by conducting public meetings. Yet, Green Alternative thinks the population is not a real part of the decision making process; rather, they are merely passive listeners at these public meetings. General concerns about increased tariffs, environmental harm and compensation were expressed in the public meetings. The Ajar project had an incident in the summer 2012 where the company marked the private land it expected to be flooded before consulting the affected landowners. It illustrates a lack of communication between the company and the affected population. The AGL project had letterboxes placed in the affected areas, but people still preferred other means for expressing concerns. All in all, it is likely that the two projects will not affect the population in a significant way; no one will lose their home, and no culturally important sites are to be flooded. Thus, the two cases are not among the most controversial ongoing construction projects in Georgia.

Returning to the main question of the thesis, there have been incidents where environmental and social aspects of greenfield hydropower developments have been given less attention. Hence, the quest for FDI have some negative consequences. Climbing the EDBI has come at the expense of much needed reform, for instance, to improve labour rights and introduce

adequate resettlement laws. The EDBI has throughout the thesis been a useful tool to illustrate reform efforts of the government to make Georgia an attractive investment destination, but the two cases exemplified that the ranking does not tell the whole truth about doing business in Georgia.

In conclusion, though improvements have been made, there is still some way to go before every Georgian feels the benefits of development achievements in the energy sector. FDI can play a role in Georgia's socio-economic development, but the key word here is "can". As this thesis has shown, the government has been eager to become make Georgia an attractive place for foreign investments and the drive to obtain FDI has placed concerns about environmental and social aspects of Georgian society in the background. The reforms have to great extend focused on attracting FDI, and less effort has been made to ensure environmental protection or improvements of the population's lives. For instance, when it comes to property issues it remains clear that there has been little real progress. Still, the picture is complex, and all the potential impacts may not yet be evident. With a new government in 2012 and a new president in 2013, Georgia might yet again embark on a new policy path, perhaps towards a more socially inclusive one.

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